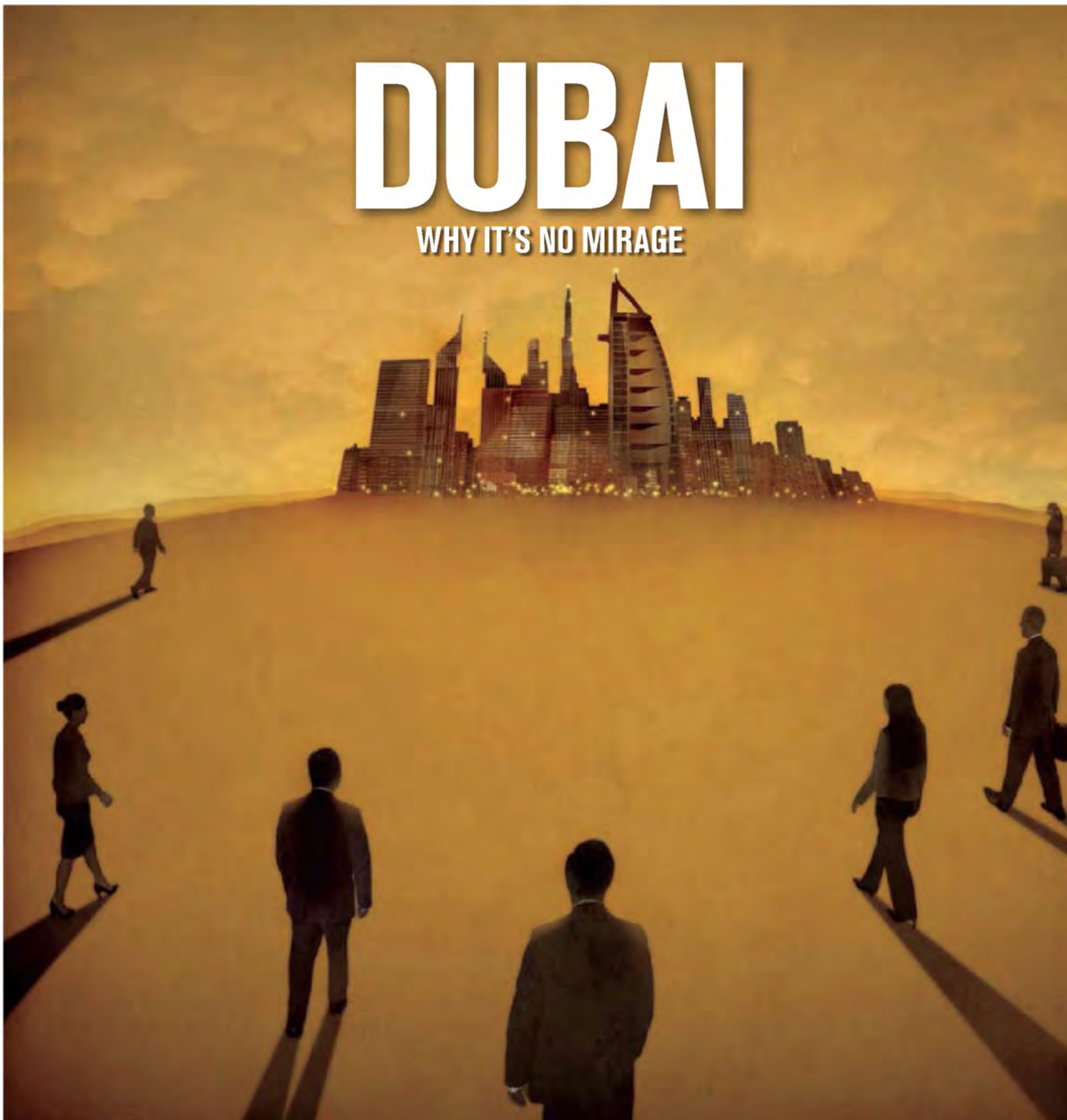
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THE BATTLE INSIDE GM | CAN AOL BE SAVED?

Bloomberg BusinessWeek

DUBAI
WHY IT'S NO MIRAGE




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AOL's Armstrong has 100 million unique monthly visitors—and serious rivals

IN DEPTH

CRISIS IN THE GULF: WHY DUBAI MATTERS

034 | Sure, it's going to pay a hefty price for its debt woes. But the city-state's open economy has attracted legions of foreign investors and serves as a model for its conservative, autocratic neighbors in the Persian Gulf. | BW |

CAN THIS MAN SAVE AOL?

042 | Tim Armstrong may have the toughest job in media: Trying to teach an old digital dog the new tricks that will make it relevant to users and advertisers. Among the obstacles he faces: Yahoo!, Microsoft, and a slew of startups. | BW |

BEWARE SOCIAL MEDIA SNAKE OIL

048 | Many executives are drawn to the opportunities they see in social media. And they're listening to hordes of marketing "experts" enthusing about Facebook, Twitter, and blogs. But all the hype may obscure the real potential of these tools. | BW |

(COVER) ILLUSTRATION BY MATT MAHURIN; (THIS PAGE) BRAD TRENT



THE BATTLE INSIDE GM

The ouster of Fritz Henderson may make tactical sense. But the second-guessing of Ed Whitacre (above) and other industry outsiders on the board has insiders worried. |BW| PAGE 020



Cisco Systems' Sandeep Vij, in Bangalore, has put *jugaad* to use

A MANAGEMENT CRAZE FROM INDIA

Jugaad is becoming a buzzword among management consultants. The term, which is Hindi slang, has come to mean fast, cheap, customer-centric innovation. And it's catching the attention of Western executives. |BW| PAGE 057

004 THE BUSINESS WEEK

004 **EXECUTIVE SUMMARY** Henderson leaves GM; trouble in Dubai; Obama's plans for Afghanistan

009 **BTW** Corralling shoppers through Twitter and e-mail; the perils of younger bosses; foie gras flareup

012 **BUSINESS OUTLOOK** Jim Cooper says Americans—despite job and debt woes—are starting to spend

015 **NUMBERS** Clear signs that the corporate credit crisis is over

017 **FACETIME** Susan Berfield talks to Susan Lyne, CEO of luxury e-tailer Gilt Groupe

020 NEW BUSINESS

020 **THE BATTLE INSIDE GM**

022 **AN EMBATTLED FED FIGHTS BACK** Bernanke is unapologetic and warns that moves to weaken the central bank could threaten the economy

026 **MORE CENTRAL BANKER WOES** Why the days may be numbered for Mexico's Guillermo Ortiz

028 **JOHN PAULSON'S 15 MINUTES** He won big betting against subprime, but is he a one-megahit wonder?

030 **WHAT LURKS ON BANKS' BOOKS** While profits have rebounded, shaky home-equity and credit-card debt could nail them again

032 **GAMBLING ON ASIA** Challenges for Sheldon Adelson's casino complex in Macao

054 WHAT'S NEXT

054 **MICROSOFT-STYLE PHILANTHROPY** Gates Foundation CEO Jeff Raikes is applying the software giant's intensity to the charity

057 **MANAGEMENT CRAZE FROM INDIA**

058 **COUNTRY REPORT: KOREA** As its conglomerates thrive, they also put the nation's innovation at risk

061 **E-COMMERCE PHANTOM** Meet online retail powerhouse GSI

062 **SMALL BIZ CREDIT CRUNCH?** Relief from Congress may be late

064 **WIRELESS SHACK** Radio Shack's new focus on wireless gear puts it up against Wal-Mart and Best Buy

065 **COPENHAGEN'S BRIGHT SIDE** An expected boost for green industries

067 PERSONAL BUSINESS

067 **MONEY REPORT** Betting on the Chinese consumer; hedge funds go stock shopping; gold's new heights

068 **HOW TO PLAY IT** South Korea offers the best of both the developing and the developed worlds

070 **LIFE MANAGEMENT** Clearing some of the financial hurdles facing nontraditional families

073 **INSIDE WALL STREET**

075 BUSINESS VIEWS

075 **BOOKS** Our roundup of the year's best business books—including must-reads on the financial crisis

078 **FEEDBACK** Readers are split on the new threat from Wall Street

080 **TECH & YOU** Intel's Reader is an advance for the visually impaired on the same scale as braille

079 **COMPANY INDEX**

(L-R) JOHN F. MARTIN/GENERAL MOTORS/REUTERS; NAMAS BHOJANI

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THE BUSINESS WEEK

EDITED BY HARRY MAURER & CRISTINA LINDBLAD



GM's board decided that Henderson was not the right man for a turnaround

LEADERSHIP

SO LONG, FRITZ

The rumors had been buzzing for weeks: **Fritz Henderson's** driver's-seat days were numbered at **General Motors**. After all, **Chairman Edward Whitacre Jr.,** former boss of **AT&T,** seemed to be doing the steering, along with a highly independent board that had spurned one of Henderson's key decisions. So the unceremonious ouster of Henderson on Dec. 1 wasn't exactly a shocker. The newly constituted board apparently concluded that the 25-year veteran was too closely linked to the clunky old GM to undertake the redesign that's needed. Now the search for a new CEO begins, and Whitacre promptly told employees that it could take as long as a year.

Meanwhile, there seem to be an awful lot of hands on the wheel. Private equity executives on the board have proven vociferous, say insiders. And critical issues loom: how to repair the European business, burnish the brands, design new models, and build a management team.

| BW | PAGE 020 "The Battle Raging Inside GM"

FINANCE

DRAMA IN DUBAI

It was widely known that glittering Dubai, land of the indoor ski slope and the palm tree-shaped artificial islands, was suffering financial trouble. But this much trouble? On Nov. 25 the emirate, led by **Sheikh Mohammed bin Rashid Al Maktoum,** said it would seek a six-month halt in payments on $18 billion in debt owed by state-controlled **Dubai World.** Both the government and Dubai's main financial backer, **Abu Dhabi,** studiously avoided pledging that they would stand behind company debt, even if the company was an arm of the state. That gave investors the shakes about all emerging markets and cast a pall over Dubai's ambitions to be a regional financial center. After a one-day sell-off on world bourses, most recovered with ease. But stock indexes in the Persian Gulf region dropped and stayed down, as did the price of **United Arab Emirates** debt securities. Holders of $3.5 billion in bonds issued by **Nakheel,** a Dubai World real estate unit, banded together to resist any attempt to change the terms. But don't count Dubai out: This cash crunch could prove to be a blip.

| BW | PAGE 034 "Why Dubai Matters"

ECONOMICS & POLICY

SHOPPERS DO THEIR BIT

As might be expected with the U.S. economy mending but



Maktoum: Dubai World proposed a six-month debt moratorium

(FROM TOP) BILL PUGLIANO/GETTY IMAGES; KARIM SAHIB/AFP/GETTY IMAGES

joblessness holding north of 10%, consumers staged a mixed performance over the **Black Friday** weekend. The **National Retail Federation** reported on Sunday, Nov. 29, that more shoppers hit stores and Web sites than in 2008 but spent less freely, leaving total outlays at $41.2 billion, slightly up from last year. But online-only sales numbers displayed some proper holiday cheer, rising on Black Friday and **Cyber Monday** by 11% and 13.7% respectively, according to researchers **Coremetrics** and **comScore.** This early spending spree might not herald a better holiday season: Shoppers may have simply opted to amass more gifts early to take advantage of discounts, analysts say. (For another take, see page 8.)

"Online Retailers: An Early Holiday Peak?" businessweek.com/magazine

EXPENSIVE ESCALATION

President Barack Obama's addition of 30,000 troops to the American force in Afghanistan, which was announced on Dec. 1, will push the cost of the two post-September 11 wars past $1 trillion. Obama's $30 billion estimate for the surge in the current fiscal year triggered much gnashing of teeth among both political parties. Unlike in previous years, Congress is trying to account for the cost of the Iraq and Afghanistan wars in the annual budget bill, not in one-off supplementary allocations. At least one Democrat suggested a special tax, while Republicans would like to deploy unspent stimulus funds.

MODIFY THOSE LOANS!

When the **Treasury Dept.** unveiled a voluntary, paperwork-heavy foreclosure prevention program early this year, many observers scoffed that its offer of $1,000 a year to lenders that ease mortgage terms would have little impact. And so it has proved, leading Treasury **Assistant Secretary Matt Barr** to scold recalcitrant banks on Nov. 30 and threaten that they'll "suffer the consequences" unless more loans

LOCATION, LOCATION, LOCATION

Ten cities with most expensive office markets. (Office rents, $ per square foot)*

$184.85	London's West End
$171.64	Inner Central Tokyo
$137.61	Central Hong Kong
$131.55	Moscow
$122.51	Paris
$121.11	Mumbai
$108.91	Dubai
$88.92	New Delhi
$88.66	Luxembourg
$87.47	Rio de Janeiro

*As of Sept. 30, 2009
Data: CB Richard Ellis

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May require up to a $36 activation fee/line, credit approval and deposit. Up to a $200 early termination fee/line applies. **Mobile Broadband Card Offer:** Offer ends 1/1/10 or while supplies last. **Business Account:** Available to corporate-liable customers only. Taxes and service charges excluded. No cash back. Requires activation at the time of purchase. A Sprint Mobile Broadband Card data plan is required. **Upgrade:** Existing customers in good standing with service on the same device for more than 22 consecutive months currently activated on a service plan of $39.99 or higher may be eligible. See in-store rebate form or sprint.com/upgrade for details. **Other Terms:** Coverage not available everywhere. 4G is currently available in limited areas and on select devices; check sprint.com/4G for Sprint 4G coverage/device info. The 3G Sprint Mobile Broadband Network reaches over 253 million people. Offers not available in all markets/retail locations or for all phones/networks. Pricing, offer terms, fees and features may vary for existing customers not eligible for upgrade. Other restrictions apply. See store or sprint.com for details. ©2009 Sprint.

006 EXECUTIVE SUMMARY

are modified faster. The Treasury insists that the effort is on track: Some 650,000 borrowers have won temporary breaks on their payments—averaging $576 a month—though 20% of those haven't filed any of the paperwork needed to receive longer-term help, and 37% have filed only partial paperwork. Some 375,000 could get long-term reductions by yearend, but only if banks hustle, officials said. Now Washington is demanding daily reports and sending in "SWAT teams" to look over servicers' shoulders; banks that drag their feet could be subject to financial penalties. The number of homeowners who are already in foreclosure or at least 90 days past due on their loans currently tops 4 million.



Foreclosed in Florida: The Treasury is pressuring lenders

J PAT CARTER/AP PHOTO

INDIA SIZZLES

Take a look at India, and one might be tempted to think the global downturn is done for. For the quarter ended Sept. 30, gross domestic product grew at a splendid and surprising 7.9% rate, the best since 1996. True, the economy had never really buckled, even in the midst of last year's maelstrom, because a well-targeted $80 billion stimulus kept growth rates close to 5%. Now, though, comes the tricky part. Does New Delhi, which has cut interest rates by 4.25% since October 2008, start rolling back tax cuts that have pushed the deficit to nearly 12%? Or does it keep kicking the economy into action and risk having its debt downgraded to junk? Stay tuned.

"India's Economy Shows Surprising Growth" businessweek.com/magazine



THE *BUSINESSWEEK*/ YOUGOV OPTIMISM METER

ANGST OVER EQUITIES

The Optimism Meter, a proprietary measure of sentiment and expectations, economic statistics, and market forecasts, fell to 42 on Dec. 1 as the 12-month outlook for stocks turned more negative. The meter has dropped from a high of 47 on Nov. 18. Developed to track shifts in outlook among individuals, professional investors, and economists, the meter gauges optimism about jobs, markets, and growth.

*Calculated using consumer polling, economic forecasts, and financial markets data; 0=lowest and 100=highest
Data: YouGov, Bloomberg, *BusinessWeek*

EASY MONEY IN JAPAN

A mere two weeks after **Bank of Japan Governor Masaaki Shirakawa** warned that cheap credit in the wealthy nations risked inflating bubbles in emerging markets, the BOJ itself plumped for easier money. Why? The fast-climbing yen and a new round of deflation threaten to strangle Japan's nascent recovery. After an emergency meeting on Dec. 1, the bank's monetary policy board, under pressure from **Prime Minister Yukio Hatoyama's Democratic Party** administration, said it will offer $115 billion in short-term loans to commercial banks at an interest rate of just 0.1%, accepting government and commercial bonds as collateral. The next day, the bank injected $11.5 billion into short-term money markets, the first such operation in a year. Critics, however, wasted no time in lambasting the moves as too timid.

TECHNOLOGY

NOKIA SUES AGAIN

Make good handsets—and have a good team of lawyers handy, just in case. That seems to be Nokia's philosophy lately as the world's biggest cell-phone maker has waxed downright litigious. Several months ago it sued **Apple** for patent infringement. On Dec. 1 it announced suits in Britain and the U.S. against 11 display manufacturers for price fixing. Nokia

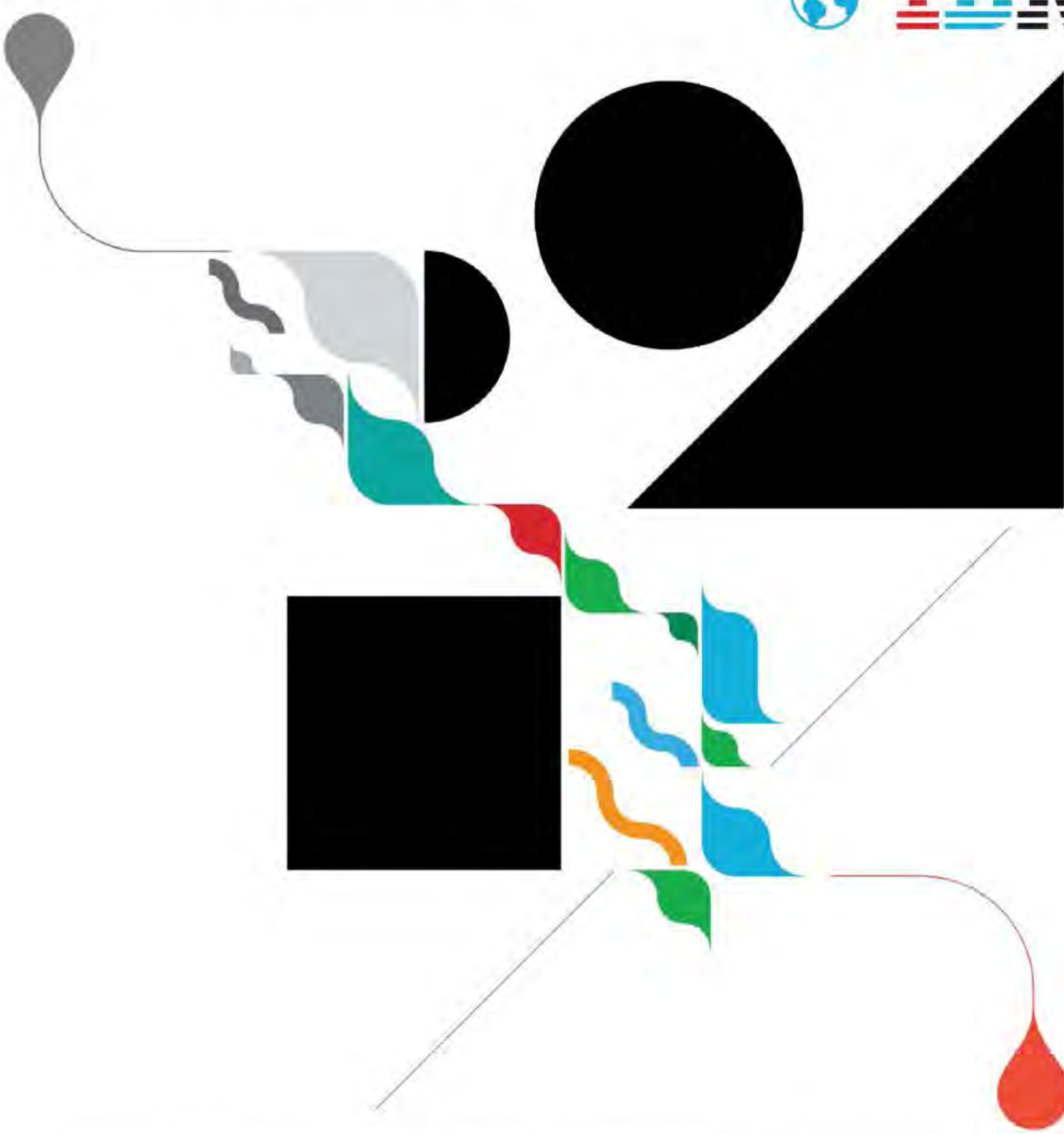
Smarter business for a Smarter Planet:

Is it possible to build a supply chain that delivers intelligence?

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claims it paid suspiciously high prices for LCD screens between 1996 and 2006 and will seek undisclosed damages. The filing comes a year after the **Justice Dept.** fined several display makers $585 million for colluding on prices.

STRATEGY

DOWN AND UP AT AIG

There's no rest for the weary at **American International Group.** On Nov. 30 a report by research firm **Sanford C. Bernstein** spotlighted a shortfall of $11.9 billion in reserves at AIG's property and casualty operations. That knocked 14% off the stock price. But the next day shares bounced partly back on the announcement of a plan to repay $25 billion of AIG's loan from the **Federal Reserve Bank of New York.** The deal sets up two special-purpose vehicles to pave the way for an IPO or sale of two major life insurance businesses, and the bank will be first in line for payback from the proceeds. That chops the insurer's credit line at the bank from $42 billion to $17 billion. All told, the government's assistance to the company stands at $120.7 billion.



AIG CEO Robert Benmosche: Does the company have a large shortfall in reserves?

THE PEACOCK MAY FLY

It cost a bit more than **General Electric** had hoped—$800 million more, to be precise—but this deal appears to have cleared the decks for **Comcast's** takeover of **NBC Universal.** On Dec. 1, after a week's stalemate, French telecom giant **Vivendi** agreed to sell its 20% stake in NBC Universal to 80% owner GE for $5.8 billion, up from the initial offer of $5 billion. That should allow GE to merge NBCU, comprising the TV network, **Universal Pictures,** and a brace of cable channels, with Comcast's channels in a complex setup that would give Comcast 51% control and GE 49%. The merger could be announced by Dec. 3.

IDEAS BLACK FRIDAY MAY BE LOSING SOME MAGIC

For all the media attention focused on Black Friday, there's new evidence that it's getting a little gray for retailers. "No longer is Black Friday a single-day phenomenon," argues **Marshal Cohen,** chief industry analyst at market researcher **NPD Group.**

A new report titled "The Anatomy of Black Friday 2009," based on an NPD survey of 1,800 U.S. consumers, indicates that Americans are ever more inclined to spread out their shopping over the entire holiday shopping season, both in stores and online. One reason that's especially true this year is that big-name retailers, including **Wal-Mart** and **Amazon.com,** launched discounts and other promotions as early as October. But hard-core bargain hunters may be disappointed. In 2008 desperate retailers slashed prices up to 75% on their entire inventory, sacrificing profits in the process. The norm this year are discounts of 40%, and only on selected goodies, says Cohen.



Shopping in Virginia on Black Friday: Discounts averaged 40%

NPD identified another trend that may bring tidings of joy and good cheer to the nation's beleaguered retailers. Americans are showing signs of "frugal fatigue." A full 63% of those surveyed said they purchased something for themselves on Black Friday in addition to gifts for loved ones, with many saying they felt the need to reward themselves for holding back all year.

NPD Group

(FROM TOP) NIKOLA SOLIC/REUTERS; JIM YOUNG/REUTERS

EDITED BY DEBORAH STEAD



ILLUSTRATION BY RICH TU

COAXING SHOPPERS OF A FEATHER TO FLOCK TOGETHER

The blue light special is back—with a social media twist—at Groupon, LivingSocial, and BuyWithMe, a new breed of e-tailer that uses collective buying power to get steep discounts from local merchants. Retailers in New York, Chicago, Atlanta, and other cities are signing up with the sites to offer discounts of up to 90% on items. The catch: Each markdown is activated only after a number of consumers commit to purchasing. The stores set that threshold, sending those who buy online a printable coupon to bring to the store.

To create a sense of urgency, the sites put up limited-time offers daily, using Twitter and e-mail to stoke demand among their members. "They've stumbled on a value proposition that's appealing," says Sucharita Mulpuru, an analyst at Forrester Research. Groupon, with 1.5 million members, is the most popular of the new services. After launching in Chicago a year ago, it has expanded to 45 cities. By now it has sold 855,000 items, it claims, at a collective discount of $37 million.

For merchants, the appeal of such sites is straightforward. In October, Balani Custom Clothiers, a small Chicago outlet, offered a $225 gift certificate for $95 on Groupon. The site sold 850 of them that day, a number equal to the customers Balani would attract in a year and a half, says shop owner Sonny Balani. "We're slammed now," he says. "That is to say, happily busy."

Such group shopping may be a bright spot in what's expected to be a somber holiday season, online and off. Web tracker ComScore expects 3% growth in online sales this holiday season. That's better than last year's 3% decline but anemic compared with the 22% average growth of the three prior years.

Andrew Mason, Groupon's founder, expects his sales to top $100 million in the next year. The question (think eBay): Will this latest twist on e-commerce fade once the novelty wears off? *—Heather Green*



WHEN BOSSES AREN'T READY

How key is a good boss? A new study suggests a decline in qualified managers is detectable in productivity figures. Using "a bit of theory and a bit of data," Dartmouth economics professor James Feyrer looked anew at the drop in productivity growth from the 1970s to the mid-1990s—a time when U.S. output per hour grew roughly 1.5% a year, vs. 3% in the 1960s (and now). One idea about the falloff is that it coincided with a flood of novice employees, as baby boomers went to work. Believing this alone wouldn't explain it, Feyrer searched for a "spillover effect"—and found it in management. Census data from the period showed a rise in workers classified as managers and a dip in managers' median age—from 43 in 1970 to 38 by 1980. Feyrer hypothesizes that the need for more managers, given the boomer influx, had businesses tapping some who weren't ready. Managers' median age was back up by 2000 (to 42), he notes, along with productivity growth. The "management effect," he says, accounts for about 20% of the observed slowdown.

ANIMAL RIGHTS IN THE CITY OF LIGHTS

In their campaign to ban foie gras, European animal-rights groups are bringing their fight to France, which accounts for 75% of the liver delicacy's global output. Activists plan a rally in Paris on Dec. 12 to urge their countrymen to forgo foie gras, a popular item at holiday feasts. On Nov. 27 two of the groups released a survey by pollster CSA that found 44% of the French favored a ban on traditional foie gras production, which involves force-feeding ducks and geese to enlarge their livers to at least four times normal size. "We were pleasantly surprised" by the poll's results, says a spokeswoman for one group, L214, which takes its name from a French law on treatment of animals.

British department store group Selfridges recently agreed to stop selling foie gras after being targeted by protests led by former James Bond actor Roger Moore, who has called foie gras "torture in a tin." Netherlands activists have pressured such hotel groups as Mövenpick and Carlton to stop serving the delicacy at Dutch locations. But in France, where foie gras is a $2.5 billion business, such groups face an uphill battle. The French eat 18,500 tons a year. And while 63% of those polled agreed force-feeding was "a source of suffering," only 19% said they'd refuse to buy foie gras. *–Carol Matlack in Paris*



Corn is force-fed to a duck at a poultry farm in France

ILLUSTRATION BY RICH TU; PHOTOGRAPH BY REGIS DUVIGNAU/REUTERS


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toyota.com/beyondcars
WE SEE BEYOND CARS.
WE SEE A GREENER TOMORROW. At Toyota, we believe that the best way to have an impact on the environment is to have as little impact as possible. It's why we have a zero emissions vision for our vehicles, not to mention a drive towards zero waste in all our plants. In fact, we spend $23 million every day researching future technologies. Can a car company help improve the environment? Why not? To us, it's all part of the big picture.
Pictured: Roxanna De Maria & Jesse Blanc, Toyota Associates
Toyota Prius, the world's first mass-produced hybrid
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CONSUMERS ARE OPENING THEIR WALLETS AGAIN

Despite weak labor markets, heavy debt, and low confidence, U.S. households have already begun to spend, especially on services

American consumers have always been a resilient bunch in the face of adversity, but last year was just too much to handle. They can be excused for bailing out amid $4 gasoline, plummeting home prices, and fears of another Great Depression. A year later, however, households are once again doing what they do best. They are spending—cautiously, but with enough punch to keep the economy moving forward.

The road ahead for consumers will be hard, yet the recent upturn in their spending is both encouraging and surprising. Outlays adjusted for inflation and excluding autos grew at a 2.6% annual rate from May through October. That's not too shabby considering weak labor markets, bombed-out household balance sheets, and damaged confidence. Plus, given solid gains in both September and October, non-auto outlays are on track to rise faster this quarter than they did last quarter.

6%

Annual rate of increase in income of small business proprietors from May to October, the fastest since 2006

Data: Commerce Dept.

The momentum is most evident in spending for services, which account for two-thirds of all consumer outlays. Over the past three months, inflation-adjusted spending on everything from housing to health care to recreation has grown at the fastest pace in more than two years. As a result, despite the sharp drop-off in car sales as the cash-for-clunkers program ended, overall consumer spending this quarter is set to contribute positively to economic growth for the second quarter in a row, something that seemed doubtful only a couple of months ago.

The key factor accounting for the resilience: Job losses are diminishing, allowing income from wages and salaries to stabilize, while non-wage earnings from rents, assets, and small proprietorships have grown. The government's October report on personal income included significant upward revisions from April through September. The numbers now show overall income rose at a 3.3% annual rate in the second quarter and 1.3% in the third, up sharply from the originally reported 0.6% and –0.5%, respectively, including a sizable upward refiguring of labor income.

The healthier picture of households also includes greater savings. Over the past three months, consumers saved an average of 4.3% of their aftertax income, more than a percentage point higher than previous data had shown and up from a record low 1% a year and a half ago. At the same time, the stock market rally and the stabilization in home prices suggests that households have now regained about a third of the $14 trillion in net worth they had lost since the third quarter of 2007.

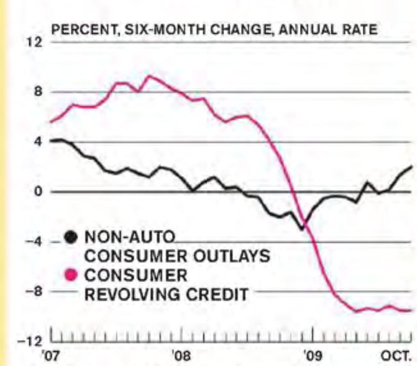
These trends show that, despite still-heavy debt, consumers are making at least slow progress in repairing their financial positions. Moveover, balance-sheet repair is not preventing consumers from contributing to the recovery. In fact, the pickup in non-auto spending in recent months has occurred even as the volume of household revolving credit has shrunk at about a 10% annual rate.

Consumer spending will stay on track only with help from the job markets, and the recent trend in weekly jobless claims looks hopeful. New claims dipped to 466,000 on Nov. 21, the fewest in more than a year and a level, if sustained, that is consistent with stronger payrolls.

The rapid shrinkage in claims is also consistent with the pattern seen in strong economic recoveries, according to economists at JPMorgan Chase. They note that the fall in claims is tracking the pace of decline seen in the strong rebounds following the 1973-74 and 1981-82 recessions, compared with the much more gradual decreases after the 1990-91 and 2001 recessions.

One ingredient still missing from a better consumer outlook is stronger faith in the future. That will depend on more jobs. With October unemployment at 10.2%, consumer confidence in November, while off its record low, remains close to its nadir in the 1990-91 recession. For now, though, the data show that working families are already feeling better about lifting their spending, and that could be welcome news for retailers this holiday season. | BW |

SPENDING IS PICKING UP EVEN AS DEBT SHRINKS



Data: Bureau of Economic Analysis, Federal Reserve, IHS Global Insight

BRAD TRENT; CHART BY DAVID FOSTER

barcelona
world race



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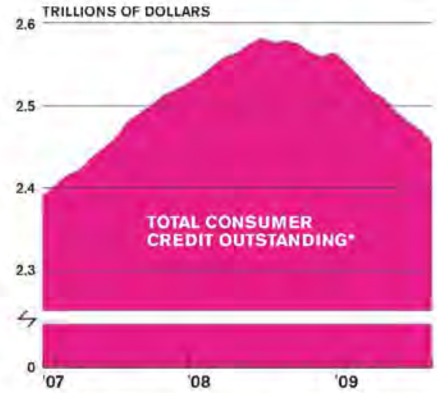
NUMBERS

IS THE CORPORATE CREDIT CRISIS OVER?

by Tara Kalwarski/Charts by David Foster

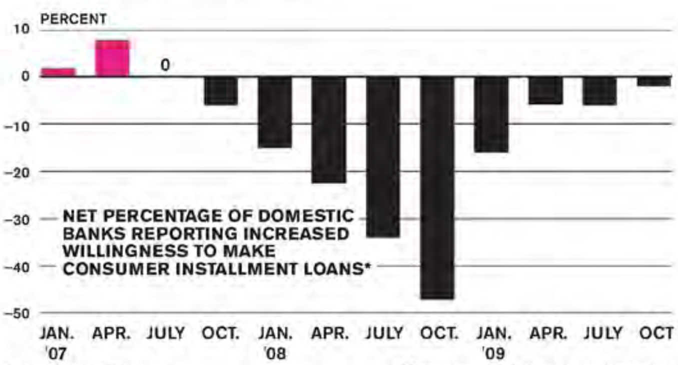
Companies have issued more than $2.8 trillion in bonds this year, a clear sign credit conditions have eased. And as risk has fallen, banks are again willing to do business with each other. But credit is still contracting for consumers, albeit at a moderating pace.

Personal Debt Drops: Nonmortgage consumer debt has dropped by $126 billion since 2008.



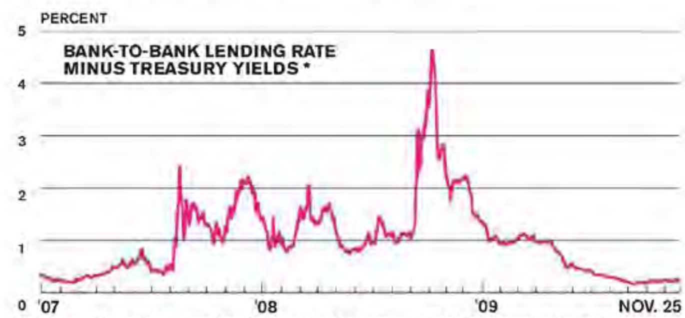
Data: Federal Reserve * Seasonally adjusted

Scary Consumers: The number of banks willing to lend to consumers is still shrinking.



Data: Federal Reserve *Compared with three months earlier

Lower Risk Levels: The perceived risk of bank-to-bank borrowing has fallen to pre-crisis levels.

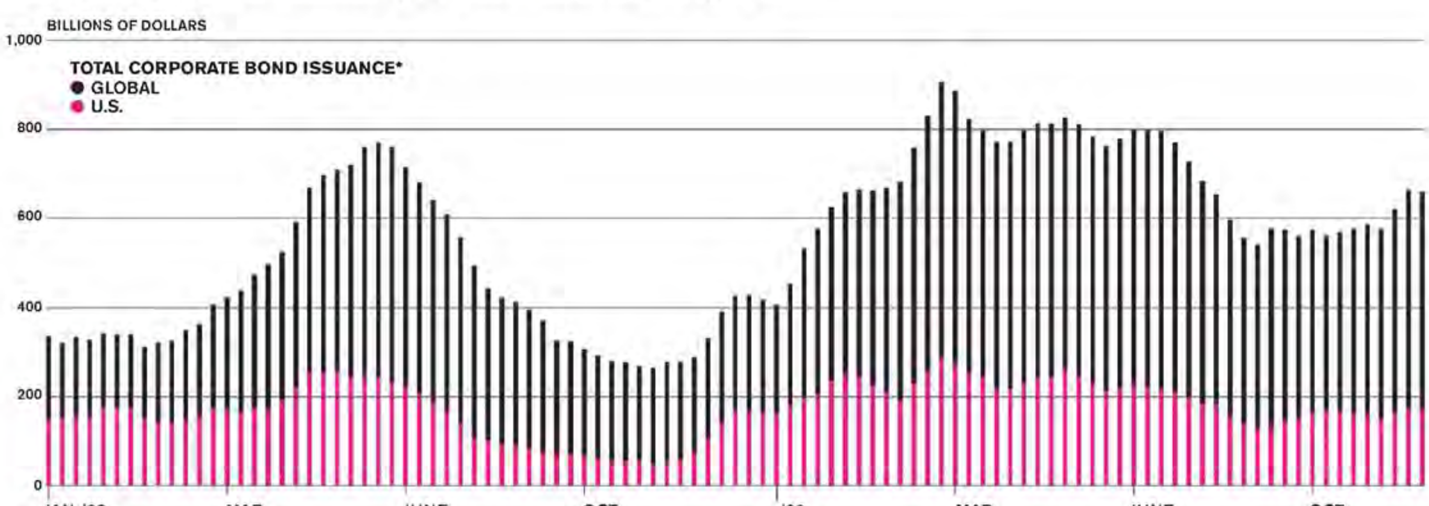


*Calculated by subtracting the yield on the three-month U.S. Treasury bill from the three-month London Interbank Offered Rate (the rate at which banks lend to one another)

Data: Bloomberg

BUSINESS BORROWING COMES ROARING BACK

Worldwide, businesses have so far issued 40% more debt in 2009 than they did in all of 2008. But issuance by U.S. companies is up only 18%.



Data: Dealogic *12-week sum; includes investment-grade and high-yield debt



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FACETIME



ROBYN TWOMEY/CORBIS OUTLINE

SUSAN LYNE ON GILT.COM'S PLEASURES AND PRESSURES

Black Friday, Cyber Monday. Those days go mostly unnoticed at Gilt Groupe, the two-year-old online luxury retailer. The Great Recession has worn down much of the fashion world, but Gilt seems to have figured out how to sell designer clothes and other high-end items despite all the wary shoppers out there. It creates an illusion of exclusivity: Shoppers have to become members (though there's no charge to do so). It doesn't make us feel too guilty since most items are discounted by about 60%. Gilt plays to our impulsive, thrill-seeking selves by putting up new enticements every day, precisely at noon, and taking them down 36 hours later. The privately held company says its main business, women's apparel, is profitable. Susan Lyne became chief executive a year ago after running ABC Entertainment and Martha Stewart Living Omnimedia. She spoke with *Bloomberg BusinessWeek* Associate Editor Susan Berfield about retail—online and off—and Gilt's future.

SUSAN BERFIELD

Bloomberg reported on Dec. 1 that despite a strong Cyber Monday, the outlook for retail spending is discouraging. What's your view?

SUSAN LYNE

I think it's a tale of two cities. Offline retail is going to still struggle. Yes, consumers went for the incredible deals, but not much else. Until people are truly comfortable that the economy is on a real upswing their purchasing is

going to be significantly restrained. But e-commerce is the beneficiary. One reason is that you can do comparison shopping. People feel more comfortable that what they are buying they are buying at a good price. At Gilt, people who would be deeply uncomfortable spending full price feel like they've saved money, not spent money. There is a psychological lift. And there is pent-up demand. I think people want to shop. It makes us feel better.

You joined Gilt in September 2008 just as the economy started to fall apart. What happened at Gilt?
People kept buying. We never had a day where I could say, "Oh my God, they're not buying because they are afraid they are going to lose their jobs, they are impacted by the downturn." What I realized is that shopping is more than a necessity. It's something that gives people genuine pleasure. Our growth didn't begin when the market turned down. I joined Gilt because it was in hypergrowth. The model works no matter what.

But Gilt benefited because there were so many unsold designer clothes piling up. That's not the case now.
Yes, brands are reducing inventory. There is not the same glut, which is ultimately a good thing. We need a healthy apparel industry for our company to flourish. Wherever we can, we are trying to work with our brand partners to make sure we support their core business.

2 million
Members since Gilt's 2007 launch

$400 million
Expected sales for fiscal 2009

How do you do that?
We work with 650 different brands. Sometimes we offer to buy a certain number of pieces from a new collection. So we might say we'll take at least 150 of these and as many as 250. If you can sell that extra 100 to the department stores or your retail partners, God bless. If you can't, we'll take them. It's a safety net for the brands.



Gilt.com fashion shoot: The company works with 650 different brands

How much influence do you have with those brands?
We have an enormous amount of data about our customers. We know not only what you buy, we know every sale you visited, every item you clicked on, anything you tried to add to your cart, anything you wait-listed. We give all this information to the brands. And we use it, too, of course. We say, "We want more of that." We take the brands' excess, yes. But they also make more [of what we request] or they make specific items for us.

Initially your inventory must have been fairly random.
When we started it was opportunistic. Part of it still is. But increasingly we're saying we're going to need x million dollars of product from this brand in six months. How do we get there? In some cases, it could be a mini-collection or a proprietary line for Gilt. We're focused on that because being able to plan our product pipeline is just as important for us as for any retail business.

So are we going to see a Vera Wang line for Gilt soon?
We're already offering many items that are made just for Gilt. In terms of whole lines, we have signed several deals. The first will be available in the first quarter of 2010.

Whom have you signed deals with?
I can't say.

Doesn't Gilt operate more like a department store than people might think?
But there's no store in the world that could change its entire inventory in a night. We do that every night. Customers know they'll see something new tomorrow.

What's your biggest threat?
None of the obvious potential threats worry me very much. The real threat is always the equivalent of the kid in the garage in Palo Alto. Our version of that is two smart young women who come up with another addictive shopping experience that disrupts e-commerce. What made Gilt such a fast phenomenon is ... the thrill of the treasure hunt. The real threat is that someone else comes up with the next iteration of that. It's not the me-too sites that worry me, it's what's fresh.

What do you wish you had known when you started?
In some companies, you can approach the different parts of the business separately. Here everything has an impact on the customer experience. We put on a live show every day. Everything has to work. One loose thread can have an effect on the whole business. |BW|

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022 The Fed fights to preserve its powers
026 Mexico's central banker is under fire, too
028 John Paulson's star turn may be over
030 Banks: Still more skeletons in their closets?
032 Shelly Adelson's misstep in Macao

THE BATTLE RAGING INSIDE GM

Henderson's ouster leaves Whitacre and the board of mostly Detroit outsiders calling the shots. And that's making the carmaker's executives jittery

By David Welch

The Dec. 1 ouster of Frederick A. "Fritz" Henderson as General Motors' CEO was a surprise, but only in how fast it happened. Since GM emerged from bankruptcy in September, Chairman Edward Whitacre Jr. had become the de facto chief executive, and his board had reversed one of Henderson's biggest decisions. Now, as Whitacre looks for a new CEO (assuming he doesn't take the job himself), he and the directors are in the driver's seat. Whitacre and much of the board are industry outsiders. Now GM veterans are asking: Do they know what they're doing?

Dumping Henderson made tactical sense. He was a GM lifer and restructuring expert running a company that now needs a strategic visionary with expertise in reaching consumers. But firing and replacing him with Whitacre, at least on an interim basis, is risky. He will have to make big calls: how to fix the European business, burnish GM's brands, choose new vehicles, and build a management team. None of it will be easy for a former telecom guy who told employees on Dec. 2 that he doesn't even know where his office is. "Now Whitacre is on the hot seat," says James N. Hall, principal of 2953 Analytics, a Detroit-area consulting firm. "He has to listen, trust the leadership team, and filter out GM's autoimmune system." (GM declined to comment.)

WHO WILL REPLACE FRITZ HENDERSON?

Chairman Ed Whitacre could still take the job, but here are some heavy hitters with the chops to run GM



George Buckley, CEO, 3M
Brought creativity back to the company. He's known as a strong leader and could help overhaul GM's culture.



John Krafcik, CEO, Hyundai Motor North America
The former Ford executive has spearheaded Hyundai's emergence in the U.S.



Anne Mulcahy, retired CEO, Xerox
She restructured debt, pushed the company into the color printer business, and returned it to profitability.



Ralph de la Vega, CEO, AT&T Mobility
Hails from Whitacre's world and has kept AT&T rolling. With three telecom vets on the board, he'd have an in.



Denny Strigl, President, Verizon Communications
The rising star has helped run a moneymaker and made it a mobile-services leader.

(L TO R) SUZANNE PLUNKETT/REUTERS; RICHARD DREW/AP PHOTO; STEPHEN HILGER/BLOOMBERG NEWS; BRENDAN McDERMID/REUTERS; BRENDAN McDERMID/REUTERS



BILL PUG LIANO/GETTY IMAGES

The new interim CEO wants GM to increase market share using lower discounts

One of Whitacre's big challenges will be motivating a jittery staff. Right after Henderson's firing, Whitacre held a conference call with GM's top executives. Some asked if he wanted their resignations, too. Whitacre tried to assuage their concerns. "He was clear that we have good people," says an executive who was on the call. "He said: 'I can't do this without you.'"

But Whitacre's soothing words are cold comfort. He told Bloomberg News in mid-November that Henderson had the board's confidence. Two weeks later Henderson was gone. Several GM executives say the uncertainty is hurting morale. "It's almost like experience is a liability these days," one says.

Already, some top executives are getting antsy. Sources close to Vice-Chairman Robert A. Lutz say he is dismayed at Henderson's firing. The 77-year-old executive doesn't like how it was handled and has told people close to him he is not even sure what his role will be. If Lutz were to leave, GM would lose the one guy who has managed to bypass GM's sclerotic culture and build cars people will actually pay decent money for. "Is this the time to blow the whole thing up again?" wonders Joseph Phillippi, a veteran GM watcher and principal of Auto Trends, a New Jersey consulting firm.

While Whitacre looks for Henderson's replacement, GM's new hyper-independent board will be calling the shots. It's far from clear that the directors have made the right decisions so far. Particularly worrisome to GM veterans are the actions of private equity executives Steve Girsky, David Bonderman, and Daniel Akerson. All three were tough on Henderson in board meetings, say executives briefed on the discussions. They pushed Henderson to keep GM's German unit Opel rather than sell it. GM has long needed an independent board, but GM insiders fear that too much second-guessing could prevent the company from sticking to a clear strategy. (The three directors couldn't be reached for comment.)

The decision to keep Opel was divisive. The board thought it too risky to cede control of GM's European engineering works, where the company designs its small and midsize cars. Plus, GM would lose up to 1.5 million cars a year in sales. But holding on to the subsidiary is risky, too. Opel hasn't made money in a decade and is in the throes of restructuring. Finishing the job will cost GM some $3 billion and divert executive focus from the troubled North American business and expanding operations in Asia and Latin America.

As Whitacre steers GM in the interim, he may learn a few lessons. He wants GM to push market share above 20% next year from 19.7% today. But as GM phases out Hummer, Pontiac, Saab, and Saturn, the carmaker will lose more buyers. What's more, Whitacre wants GM to expand market share with lower discounts. That's a prudent goal, but people don't rush to buy damaged brands for no reason. While GM's November sales fell just 1.5%, the company outspent its rivals on incentives by at least $1,000 a car, blowing $4,300 per vehicle, says Edmunds.com. If Whitacre pulls back too much on the discounts, sales could plummet.

As for Henderson's replacement, Whitacre and the board want a non-GM person or an industry outsider such as Alan Mulally, who left Boeing and has since managed to bring Ford Motor back from the brink. But potential candidates will have to consider two facts of life: an activist chairman and board and a salary that GM's government minders have capped at $1 million. "It's a sick company with a bad ownership structure and pay constraints," says Charles Elson, director of the John L. Weinberg Center for Corporate Governance at the University of Delaware. "I don't know who they will get." The only person willing to report to Ed Whitacre may wind up being—that's right—Ed Whitacre. |BW|



AN EMBATTLED FED FIGHTS BACK

Bernanke is unapologetic and warns that moves to weaken the central bank could threaten the economy

By Peter Coy

The U.S. Federal Reserve is one unloved central bank. It stands accused of inflating a bubble, then bailing out Wall Street while ignoring the little guys on Main Street. Demonstrators in Cleveland earlier this year carried signs saying things like: "Criminals are in charge of our money." Meanwhile, Congress is considering legislation that would authorize government audits of the central bank's most sensitive policy meetings. Another bill would even strip the Fed of its bank regulatory powers. "It's actually extraordinary what's happening," says Columbia University Graduate School of Business economist Frederic S. Mishkin, a former Fed governor. "The threats to the Fed's independence are extremely serious."

The Fed, though, is fighting back, and it has the Obama Administration in its corner. It's warning critics that any serious move against the Fed would jeopardize economic stability. And not only is the Fed conceding few mistakes—it's also striving to preserve every bit of its secrecy.

This game of political chicken, observers say, is likely to produce only partial victory, with the Fed hanging onto most, but not all, of its vast powers. The most likely nick would be a limit on the powers or independence of the Fed's 12 regional bank presidents, says Tom Gallagher, head of policy research at the consultancy International Strategy & Investment. Beyond that, while the Fed's hard-line stance is strengthening the case of critics who say the regulator needs to be checked, "Major players in this process [also] understand that blaming the Fed and trying to ruin the Fed as an institution is not a solution," says Ethan S. Harris, a former Fed staffer who is head of North America economics for Bank of America Merrill Lynch.

Part of Bernanke's survival strategy has been to appeal directly to the public

MAKING HIS CASE

Fed Chairman Ben S. Bernanke laid out his argument in a Nov. 29 op-ed piece in *The Washington Post*. He criticized both the Fed audit bill co-sponsored by Representatives Ron Paul (R-Tex.) and Alan Grayson (D-Fla.) and a financial reform plan backed by Senate Banking Committee Chairman Christopher Dodd (D-Conn.) that would transfer bank regulation away from the Fed to a new independent agency that would monitor systemic financial risk. Bernanke said both measures "are very much out of step with the global consensus on the appropriate role of central banks, and they would seriously impair the prospects for economic and financial stability in the U.S."

But anger toward the Fed is running so hot that the organization will probably have to take some kind of hit to appease the public and lawmakers. The question is where it's most willing to concede ground. Oddly enough, the Fed might be able to live with some weakened version of the auditing bill, even though it comes from Paul, its most outspoken critic. Yes, the Fed's defenders say congressional audits would politicize monetary policy by

Public anger will likely force the Fed to take some kind of hit. The question is where it's most willing to concede ground

JIM YOUNG/REUTERS



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CHALLENGES TO THE FED

AUDIT
Representative Ron Paul wants to end the Federal Reserve. He has broad support in the House, though not the Senate, for a milder measure that would allow the Government Accountability Office to audit Fed monetary policy. Outlook: If passed, could face veto.

SUPERVISION
Senator Christopher Dodd is seeking to take away the Fed's bank-supervisory powers. Outlook: Dodd seems to be one of the few strong proponents of this approach.

FREEDOM OF INFORMATION
Bloomberg LP, the new parent of *BusinessWeek*, is suing to learn what collateral the Fed received for emergency loans to financial institutions during the crisis. Outlook: The Fed has already lost in federal district court and could lose on appeal as well.

forcing rate-setters to defend their actions to Congress. On the other hand, the Fed chairman already has to endure political barbs in regular trips to Capitol Hill. "People kind of forget what abuse [former Federal Reserve Chairman Alan] Greenspan used to get when he first came to office," says Timothy A. Duy, a University of Oregon economist who writes a blog called Fed Watch.

In contrast, the Fed probably won't yield an inch on the bill from its professed friend, Dodd, to strip it of bank-regulatory powers. The Fed argues that it needs to supervise banks in order to manage monetary policy correctly, because getting rates right depends on knowing the condition of the financial system. "What they really, really want to keep is their banking regulatory powers. That goes to the core," says Joseph Engelhard, senior vice-president for Capital Alpha Partners, which tracks Washington for financial clients.

For the Fed, what makes this period so dangerous is that the central bank has become a lightning rod for the severe recession and the huge bonuses going to Wall Street bankers who helped cause the mess. Congress is tapping into the public outrage. On Dec. 1, Senator Jim Bunning, the Kentucky Republican who was the only senator to oppose Bernanke's nomination in 2005, said: "His job rating would be zero minus F." Added Bunning: "He has catered to the big banks, to the Wall Street elitists, to every major money concern in the country and in the world."

Part of Bernanke's strategy is to address the public directly through forums such as *60 Minutes* and *The Washington Post*. But even some Fed supporters say Bernanke's political intransigence may be undermining his effectiveness. In Bernanke's Nov. 29 op-ed, for example, the closest he came to an apology was to say that "the government's actions to avoid financial collapse last fall—as distasteful and unfair as some undoubtedly were—were unfortunately necessary to prevent a global economic catastrophe."



Dodd's proposal would strip the Fed of its bank-regulatory powers

Meanwhile, the Fed's penchant for secrecy leads critics to suspect the worst. The Fed continues to fight a 2008 federal lawsuit by Bloomberg LP (which acquired *BusinessWeek* on Dec. 1) that seeks to find out what collateral the Fed accepted for emergency loans to financial institutions. "The problem of the secrecy is that people don't trust Wall Street, and by extension they don't trust Wall Street's interactions with the government," says Oregon's Duy. "That puts extra onus on the Fed to be more transparent, not less transparent." Merrill's Harris agrees: "The Fed over the years hasn't done itself a favor by creating this mystique."

Luckily for the Fed, it has some powerful backers, including the White House. In naming Bernanke for a second four-year term as chairman, subject to Senate confirmation, President Barack Obama said the Fed chief helped prevent another Great Depression with calm, wisdom, "bold action and out-of-the-box thinking."

Any politician tangling with the Federal Reserve also has to reckon with the bond market. If fixed-income investors fear the central bank is losing its ability to fight inflation, they will sell bonds and drive up interest rates, which would stunt economic growth. It's particularly important now for the Fed to retain its freedom of movement because there are huge sums of excess reserves in the banking system available for lending. As soon as banks resume active lending, the Fed will need to drain those reserves rapidly to keep the economy from being overstimulated. That will no doubt draw howls of protest from homebuilders and other interest groups that benefit from low rates.

While Ron Paul worries that an unconstrained Fed will allow too much inflation, the truth is more likely the opposite, says Columbia's Mishkin: A Fed that's under the thumb of a deficit-loving Congress is unlikely to be a good guardian of the dollar. In the end, that argument for Fed independence may prove decisive. |BW|

—With Scott Lanman in Washington

Business Exchange

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A Jolly Good Audit

Willem H. Buiter, who was named Nov. 30 to be the next chief economist of Citigroup, wrote in his *Financial Times* blog 10 days earlier that auditing the Federal Reserve would be "a jolly good thing!" Buiter, a London School of Economics professor, argued that an audit would make the Fed more accountable and "could well set an important precedent for... central banks everywhere."

To read Buiter's blog item, go to **http://bx.businessweek.com/federal-reserve/reference/**

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THE OTHER CENTRAL BANKER UNDER FIRE

Mexico's Guillermo Ortiz has kept prices under control for more than a decade. But his days may be numbered

By Geri Smith



MEXICO CITY
For the past dozen years, Guillermo Ortiz has served as Mexico's inflation-fighter-in-chief. Since his appointment in 1998, the central bank governor has managed to wrestle down consumer price increases from nearly 19% a year to a low of 3.3% in 2005. The Stanford-educated Ortiz has also earned the respect of Wall Street by resisting political pressures to loosen monetary policy. In the summer of 2008, he held firm when Mexican President Felipe Calderón called on the central bank to cut interest rates to stimulate the economy. "It would have been a big gamble to lower rates before we were sure that inflation was reaching an inflection point," said Ortiz in a Nov. 26 interview.

DEBT DOWNGRADE

Such acts of defiance may end up costing Ortiz his job. His second term expires at the end of December and Calderón is considering replacing him. It might not be an ideal time to make a switch: Mexico's economy is set to shrink by as much as 7% this year on a mix of plunging exports to the U.S., falling tourism revenues due to the swine flu scare, and declining oil production. The government's overreliance on oil as a source of funding is one reason Fitch Ratings downgraded Mexico's sovereign debt rating on Nov. 23 to just two notches above junk. "Given the bad economy, it's probably not a good time to remove Ortiz," says Rogelio Ramírez de la O, an independent economic consultant.

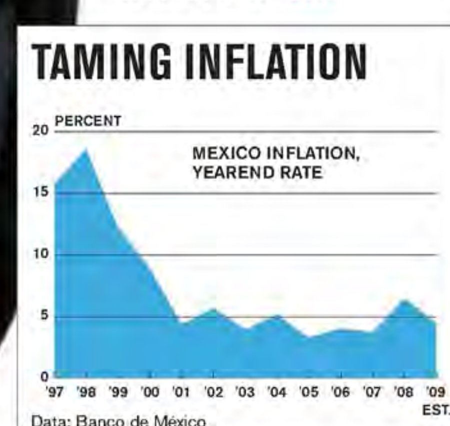
Ortiz is no stranger to crises. Named Finance Secretary in the aftermath of the 1994 peso crash, he coordinated a massive bank rescue and helped rebuild credibility with international investors. Amid the recent financial turbulence, Ortiz's able monetary management—including the sale of some $31 billion in dollar reserves—has helped stabilize the peso while keeping inflation in check.

Although Calderón recently acknowledged that Ortiz has done "good work," it's long been clear there is no love lost between the two. When Ortiz was appointed to head the central bank, Calderón, then president of the leading opposition party, lobbied to have him removed from the post, arguing that he had stuck Mexico's taxpayers with the $100 billion tab for the bank bailout. Ortiz has at times struck back. During a visit to Yale University in November, he told reporters Mexico needed "a little bit of leadership" to fix its fiscal problems, a comment that annoyed Calderón. "The fact that we have had excess oil revenues for a number of years allowed postponement of the day of reckoning, which is here today," Ortiz told *Bloomberg BusinessWeek*.

Calderón is considering nominating Finance Secretary Agustín Carstens to replace Ortiz. Carstens, 51, would be a capable successor: He holds a doctorate in economics from the University of Chicago and spent 10 years working at Banco de México before being appointed deputy managing director of the International Monetary Fund in 2003. If Ortiz proves dispensable, he may have no one to blame but himself. On his watch, Banco de México "has become one of Mexico's strongest, most credible institutions," says Jonathan Heath, chief Latin America economist at HSBC. "But if the institution is strong, it shouldn't matter anymore whether Ortiz is there or not." | BW |



Ortiz has clashed with Calderón



PHOTOGRAPH BY JANET JARMAN; CHART BY DAVID FOSTER


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JOHN PAULSON RETURNS TO EARTH

After his storied killing betting against subprime, the hedge fund hero is eking out so-so returns

By Saijel Kishan

Is John A. Paulson, the hedge fund manager who earned billions betting against subprime, a one-megahit wonder?

The founder of Paulson & Co. doesn't even look average this year. His biggest portfolio, Advantage Fund, has returned 15% vs. 17% for peers. And while his major bets on gold and big banks are paying off, such holdings aren't likely to produce the record gains that made him a rock star on Wall Street. "Paulson is quite capable of making money," says Tammer Kamel, managing partner of Toronto's Iluka Consulting Group, which advises clients on hedge funds. "But I don't think he has some crystal ball that will enable him to make [huge gains] year after year." A spokesman for Paulson declined to comment.

For years, Paulson toiled in hedge fund obscurity. A former managing director at investment bank Bear Stearns, the New York City native opened his own firm in 1994 to profit from mergers and acquisitions. He never garnered much recognition for his returns: The oldest fund, Paulson Partners, notched an average of 16% a year, decent but hardly mind-blowing gains in the hedge fund world.

As the real estate bubble inflated, though, Paulson made a massive bet against subprime mortgages, wagering that their value would crater. Two portfolios that focused on the risky loans earned nearly 600% that year, a period when the typical hedge fund gained 10%. Paulson extended his run in 2008 by shorting such big banks as Barclays, Lloyds Banking Group, and Royal Bank of Scotland.

Now Paulson, who oversees nearly $30 billion, is casting a wider net.



These days Paulson is loading up on Kraft and likes such banks as BofA and Citi

In November he doubled his stake in Kraft Foods, which is making a hostile play for Cadbury. Paulson is also trolling the bankruptcy courts for opportunities. Currently he's trying to gain control of Idearc, the U.S. telephone book publisher that filed for Chapter 11 in March.

Meanwhile, Paulson is taking a more bullish stance on financials, looking for companies that will benefit from federal stimulus. Last year his firm launched a portfolio that will provide capital to troubled banks. As part of that effort, Paulson has loaded up on shares of Bank of America and Citigroup in recent quarters. At the same time, he dumped his stake in Goldman Sachs and pared down his position in JPMorgan Chase, two financial giants that returned their bailout funds.

The question is whether the easy money has been made from such holdings. Shares of both Bank of America and Citi have more than quadrupled from their lows late last year. Paulson seems to be committed. "Banks will have passed the current writedown cycle and have visibility for growth in 2012," he wrote in his quarterly letter to shareholders, a copy of which was obtained by Bloomberg News. While BofA "has risen ... we believe considerable upside remains." Paulson figures shares of the Charlotte (N.C.)-based bank will almost double, to 30, in the next two years.

The billionaire is also sticking with gold, despite the 38% spike in its price over the past year. The firm is starting a fund that will buy stakes in mining companies and gold-related securities—a portfolio in which Paulson may invest as much as $250 million of his own money. Last month he bought a 15% stake in Detour Gold, a Toronto miner. "With gold in its current rally, it might seem like a 'me-too' trade," says Peter Rup, chief investment officer at New York's Artemis Wealth Advisors. But "Paulson was the first person to alert me to the fact that gold would be accumulated by emerging central banks, thereby providing a fundamental reason for the interest in gold." |BW|

–With Bill Rochelle, James Ludden, and Chanyaporn Chanjaroen

Despite a 38% spike in the price of gold this past year, Paulson is starting a fund to invest in gold-related securities

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WHAT LURKS ON THE BOOKS OF BANKS

Their profits have rebounded, but shaky home-equity and credit-card debt—for starters—could change that



By Theo Francis and Jessica Silver-Greenberg

At first glance, banks seem to be recovering nicely from the financial crisis. But investors cheered by optimistic earnings reports could soon face a painful surprise.

Many banks appear to be postponing inevitable losses on home-equity loans and commercial mortgages. Others face new trouble in consumer banking, especially credit cards. "Banks know they've got big holes on their balance sheets," says Paul Miller, an analyst for FBR Capital Markets.

The hopeful news is that overall bank industry earnings tripled, to $2.8 billion in the third quarter, compared with the disastrous three-month period a year earlier. But plenty of pitfalls remain, and more grief is certain if the economy takes a turn for the worse.

$21 billion

In home-equity credit lines have payments that are past due.

Data: FDIC

Consider home-equity lines of credit. During the real estate boom, many homeowners borrowed against the value of their dwellings to pay down credit-card balances, buy new cars, or even cover down payments on the very houses that anchored the loans. With property values down sharply in most markets, a lot of those loans now look shaky. Already, payments on $21 billion in credit lines are past due.

The full extent of the problem hasn't shown up yet on the books of some banks. Lenders generally don't write down questionable home-equity loans until after a borrower has stopped making payments. So far, just 2.94% of home-equity loans have defaulted, vs. 5.96% of traditional mortgages, according to real estate data company First American CoreLogic. Industry analysts predict the percentage of home-equity defaults will rise significantly.

When home-equity loans sour, the damage to banks tends to be greater than losses on traditional first mortgages. That's because home-equity lenders stand in line behind first-mortgage lenders when a foreclosure occurs. The bank holding the first mortgage has claim to the underlying property and often sells it to recoup some money. Home-equity lenders must fight for any remaining scraps. Recovery rates on home-equity lines that have gone bad averaged about 40% during the boom; mortgage-servicer Clayton Holdings says the figure now hovers near zero.

Many banks are reluctant to write down the value of their home-equity loans because that could force them to raise more capital, further denting profits. Problems with home-equity lines and other residential loans in Florida alone could shrink financial reserves at Atlanta-based SunTrust Bank by $745 million to nearly $1 billion over the next several quarters, ultimately hurting profits, according to Gradient Analytics, a research firm that serves hedge funds and other investors. SunTrust declined to comment.

Home-equity loans aren't the only weak spot in consumer lending. A number of big banks are increasingly dependent on fees, a source of profits that may soon diminish. Wells Fargo has collected $27.2 billion in credit-card and other fees so far this year, roughly 38% of its total income. Bank of America has had a 28% increase in card fees since 2007. Meanwhile, interest income at both lenders has fallen.

Fees probably will become more difficult to collect next year. Under federal rules taking effect in February, lenders won't be allowed to charge card customers for exceeding credit limits or missing a single payment. And in November the Fed banned programs that charge automatically for "overdraft protection" tied to deposit accounts. Instead, lenders now must get customers' permission to cover bounced checks. Changes to overdraft policies could cost Bank of America $200 million a quarter, according to BofA. The figure could hit $300 million at Wells Fargo.

ILLUSTRATION BY YAREK WASZUL



leaving lenders to take a nasty hit.

Trying to forestall disaster, some lenders are granting temporary extensions on commercial loan payments. The strategy has become so common that industry players now refer to it as "extend and pretend." In May, MGM Mirage got extensions on $5 billion in credit until 2011, which allowed the Las Vegas casino to finish its new CityCenter project (page 38). MGM Mirage didn't respond to requests for comment.

"HOPE IS NOT A STRATEGY"

Some analysts fear that a number of banks are cutting desperate deals with property owners unlikely to repay. "If you're reissuing loans when it's clear the borrower can't pay, that's just disingenuous," says Rachel Barnard, managing partner of Midway Capital Research & Management, a Chicago investment firm. Recent moves by the government may have encouraged the banks' dubious conduct. In late October, federal regulators said that banks don't necessarily have to write down commercial loans when the underlying properties lose a big chunk of their value. That leeway may give some banks an excuse to adjust loan values in inappropriate ways, according to industry analysts.

Dean DeBuck, a spokesman for the U.S. Office of the Comptroller of the Currency, which regulates national banks, says the guidance was intended to ensure consistent reporting and doesn't allow extend-and-pretend maneuvers. Still, says David Iannarone, president of CWCapital Asset Management: "Hope is not a strategy." |BW|
–With Christopher Palmeri and Mara Der Hovanesian

Spokesmen for the banks play down the potential peril related to dependence on fees. Much of the increased reliance on fees at Wells Fargo occurred as a result of its acquisition of Wachovia, which was completed in January 2009, says a spokeswoman. A large portion of the bank's fee income comes from its brokerage and mortgage banking units. At BofA, fee income swelled largely because of the acquisition of four smaller lenders since 2007, says spokesman Scott Silvestri. Demand for loans lagged during the past year, causing fees to grow as a proportion of the bank's revenue and income, he adds.

In response to these challenges, many credit-card companies have hiked interest rates—to as high as 30% in some cases. But the new federal rules will also make it harder to raise rates further without borrowers' agreement.

Commercial real estate presents another potential hazard. Prices have dropped 39% since the market peak in October 2007, according to the Moody's/REAL Commercial Property Price Index. Banks own some $1.8 trillion of commercial real estate loans. In many instances, the outstanding debt exceeds the property's value. Some borrowers are simply walking away,

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Debt Bombs

Dominique Strauss-Kahn, managing director of the International Monetary Fund, cast fresh doubts on the health of banks in a recent interview with *Le Figaro*. "It is possible that 50% [of bank losses] are still hidden in their balance sheets. The proportion is greater in Europe than in the U.S.," said Strauss-Kahn.

To read excerpts from the interview, go to **http://bx.businessweek.com/banking-industry/reference/**

SHELLY ADELSON'S MISSTEP IN MACAO

Attractions at his posh casino aren't clicking with no-frills Chinese gamblers, and a related IPO looks weak

By Frederik Balfour



MACAO

The Venetian casino complex in Macao is plenty grand. Singing gondoliers ply their boats along a canal that meanders through a mall featuring luxury boutiques, an 1,800-seat theater for the Cirque du Soleil, and dozens of bars and restaurants.

Problem is, most of those attractions stand half empty even as the tables and slot machines are crowded with players drinking, smoking, and shoving chips across the felt. The owner of the casino, Las Vegas Sands Chairman Sheldon G. Adelson, has made the Venetian in Las Vegas a money machine by filling its hotel rooms with vacationers, conventioneers, and of course, gamblers. In Macao, it's mostly gamblers.

Adelson's inability so far to recreate all of his Las Vegas success has investors worried, especially since he's doubling down in Asia with a gambling palace in Singapore and even more casinos in Macao. Shares in Adelson's Sands China, a spin-off from his main company, fell sharply after its $2.5 billion initial public offering on Nov. 30 in Hong Kong. (As *Bloomberg BusinessWeek* went to press, the shares had recovered somewhat.) In contrast, many other Hong Kong IPOs have seen share prices soar.

Since Macao opened up its gambling market in 2002, Adelson and others have tried to turn the seedy former Portuguese colony into a Las Vegas clone with luxury hotels, wholesome entertainment, and modern convention halls. Yet nongambling revenues account for just 14% of Sands China's sales, about half of what they are back in Las Vegas. Macao's gamblers—mostly from China—would rather leave their families at home, depriving the mall and hotel of customers. And "[convention] facilities are years ahead of current demand," says Citigroup gaming analyst George Choi. While gambling drove financial results for Sands China up overall this year, room revenues at the Venetian Macao fell 11.9% in the third quarter. Retail revenues plunged 23.8%.

The formerly seedy Portuguese colony has resisted efforts to turn it into a family-friendly Las Vegas clone

For Adelson there's no turning back. In Macao, he will soon resume construction on casinos and hotels that were mothballed last year. A payoff on the $2.2 billion earmarked for these projects may take several years. He's also rushing to complete the $5.4 billion Marina Bay Sands Resort & Casino in Singapore by the first half of 2010.

Credit Suisse analyst Gabriel Chan sees considerable "execution risk," citing cost overruns, further delays, and a hotel glut as possible factors that could derail plans. He and other analysts worry that Adelson's operations may be too levereaged. In a recent interview with Bloomberg News, Adelson said it's "completely wrong" to say Sands China may require more funds to realize these ambitions. Besides, he's confident he can raise more cash selling luxury condos next to his best hotel in Macao once financial markets pick up again. He also has the IPO money. "We'll have plenty of cash to cover any contingency," added Adelson.



Venetian Macao: Chairman Adelson hasn't duplicated his Vegas success

VOISHMEL/AFP/GETTY IMAGES

The competition isn't letting up. Gamblers flocking to Macao can choose from six casino operators. The local rival is SJM Holdings, run by tycoon Stanley Ho, who enjoyed a four-decade monopoly before Macao liberalized gambling. Ho has clawed back market share this year with his new Grand Lisboa casino, which attracts more of the mass-market Chinese gamblers who shun the frills offered by the Venetian. Adelson is no quitter. But he has a fight on his hands. |BW|

–With Chia-Peck Wong in Hong Kong

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BLOOMBERG

WHY DUBAI MATTERS

Sure, it will pay a hefty price for its debt woes. But the city-state's open economy has attracted legions of foreign investors and serves as a model for its Gulf neighbors

By Stanley Reed
Photograph by Charles Crowell



Dubai's Metro: Top-notch infrastructure attracts global companies



DUBAI

After Dubai announced in late November that the state-controlled investment firm Dubai World was seeking to reschedule payments on some $26 billion of debt, global markets went into a tailspin. While foreign bourses quickly rebounded, local shares have taken a pounding, and the credibility of Dubai's leadership has suffered serious damage. Yet lost in all the drama is the fact that Dubai is an important economic experiment in a strategically vital region. The humiliating debt implosion aside, the emirate remains the most dynamic business hub in the Gulf and has become a model for its neighbors.



In a region of conservative, autocratic countries long chained to the boom-and-bust cycles of the oil industry, Dubai stands out for creating an open economy that has diversified well beyond energy. With nowhere near the oil and gas reserves of other Gulf countries such as Saudi Arabia and Kuwait, it had to. "Dubai shows that if you are part of the global economy, you do well; you don't have to have oil," says David Aaron, director of the RAND Center for Middle East Public Policy in Washington.

There's no denying that the emirate overreached and will pay a hefty price. Dubai led the region in allowing outsiders to own property, opening up its real estate market to foreign investment in 2003, and created a mortgage industry to finance their purchases. But lax rules ushered in wild speculation. With real estate prices rising at a double-digit annual clip, investors made a killing buying apartments with low deposits and quickly flipping them. Then when the credit crunch came, buyers fled and developers saw their cash flow dry up. Hardest hit was Nakheel, a subsidiary of Dubai World that created the iconic palm island real estate development off the coast (page 38). It has about $8 billion in debt and $13 billion in other liabilities such as bills from suppliers, Barclays Capital reports.

Dubai's leadership has doubtless mishandled the recent turmoil. The emirate's debt problems have been looming for at least a year, but ruler Sheikh Mohammed bin Rashid Al Maktoum has made little progress in coming to grips with the challenge. As recently as October, Dubai raised nearly $2 billion in new money through an Islamic bond issue. Asked about the emirate's ability to pay its debts, Sheikh Mohammed told reporters: "I assure you, we are all right."

Part of the problem is that while Dubai is more open than its neighbors, it's no Jeffersonian democracy. It is dominated by a handful of people, and their decision-making and finances remain opaque. The debt crisis illustrates that. Until recently, no one knew how much debt Dubai had and which state-linked companies it might back in a crunch. Just as murky was the extent to which its wealthier neighbors, chiefly Abu Dhabi, were willing to bail it out. Investors who had assumed the best got spooked when it appeared Dubai couldn't meet its obligations. "To lower the perception of risk, Dubai must become more transparent quickly," says Matthew Vogel, head of emerging markets research at Barclays Capital in London.

HASSLE-FREE BUSINESS CLIMATE

Nonetheless, Dubai remains the region's nimblest competitor. It is a tolerant and comfortable base for anyone seeking a foothold in the Arab world, and today Americans, Europeans, Asians, and Middle Easterners work side-by-side in the senior ranks of its big companies. Salaries are high, and there's no personal income tax. Luxury apartment buildings abound, many of them weekend getaways for residents of neighboring states who flock to Dubai to enjoy lavish restaurants and bars often filled with available young women. Then there's all that famous froth such as the indoor ski slope, the sail-shaped Burj Al Arab hotel on the beachfront, and the world's tallest building, the soon-to-open Burj Dubai.

DESERT DIVERSIFICATION

Following Dubai's lead, other Gulf states are seeking to create a broad-based economy and reduce their dependence on energy.

ABU DHABI

Investing in solar power and other green technologies. Hopes to create a financial-services sector by building on management talent at the Abu Dhabi Investment Authority and other government funds. Spending lavishly on cultural and sports projects ranging from a branch of the Louvre to a Ferrari-themed amusement park and a Formula One race.

BAHRAIN

As the earliest financial hub in the region, the tiny island kingdom is now scrambling to compete with Dubai in attracting Islamic and Western-style banks. The latest bid to lure lenders is the Bahrain Financial Harbour, a $3 billion seaside city in the capital, Manama, with state-of-the art office space.

QATAR

Has earmarked some $145 billion for diversification efforts such as a financial center focusing on asset management and insurance. Has grand ambitions in culture and education: A vast Islamic art museum sits on a promontory above the Gulf, and a 2,500-acre educational center houses branches of six international universities.



"Sheikh Mo" (left) appears with Abu Dhabi's conservative leader

SIDDHARTH SIVA/ARABIAN EYE

Beneath all the glitz, though, Dubai has become a place where serious business gets done. While the city-state has just 1.6 million residents and a gross domestic product of $80 billion, it is the business gateway for a region with a $1 trillion economy, millions of eager young consumers, and hundreds of billions of petrodollars to invest. Microsoft, General Electric, Cisco Systems, and a host of other A-list multinationals have flocked to Dubai because of its open culture, top-notch infrastructure, and hassle-free business climate.

And virtually every leading investment bank is present in the Dubai International Financial Center, a lavish gray-granite complex with ornate fountains built on what was a desolate patch of sand just a few years ago. A big draw is the emerging market for Islamic financial services, which has become a $1 trillion business globally. "Dubai will continue to lay the foundations for sustainable growth," says Michael Geoghegan, group chief executive of HSBC, the leading lender in the United Arab Emirates with $611 million in loans out to Dubai World. "I am confident that Dubai and the U.A.E. will overcome any short-term issues they face."

Dubai's home-grown companies have made their mark, too. At the core of debt-plagued Dubai World is a first-class ports operation, and the company has vast real estate holdings and a host of other businesses that span the globe. Emirates, the airline founded by the ruling Maktoum family in 1985 with $10 million in capital, is now among the world's top 10 carriers and a major customer for both Airbus and Boeing. And Dubai-based Abraaj Capital, an independent group owned by local and Saudi investors, has grown into the leading private equity firm investing in the region.

Dubai's success hasn't gone unnoticed in the neighborhood, and nearby states are following its lead. Gas-rich Qatar is promoting its own financial center. Abu Dhabi has announced an $8 billion financial-services joint venture with GE. And it's working hard to transform itself into a higher-end version of Dubai with even fancier hotels and branches of the Louvre and Guggenheim museums. Even hyper-conservative Saudi Arabia has taken a leaf from Dubai's book by liberalizing its financial system to draw in Western investment banks such as Morgan Stanley and Deutsche Bank.

What these countries see in Dubai is a chance to move beyond the petro-economy that has provided their wealth but does little to create jobs. The Gulf region has millions of young, underemployed people who want a better life—and who risk being drawn toward Islamist extremism if they don't get it. Some of the most talented of these have made their way to Dubai, where they find a more meritocratic culture that offers seemingly endless opportunities. "They look at this place as somewhere that allows them to do things that they can't do [at home]," says Tarik Yousef, dean of the Dubai School of Government. "It has been built out of nothing."

HARD CHOICES

While Dubai's neighbors want to emulate its success, that doesn't mean they won't exact a serious political toll for the recent turmoil. The U.A.E., a federation of seven city-states ruled by hereditary clans, is largely bankrolled by Abu Dhabi, but Dubai is its business center. Sheikh Mo, as Dubai's leader is popularly known, is vice-president and prime minister. Abu Dhabi's ruler, Sheikh Khalifa bin Zayed Al Nahyan, serves as president, and he's unlikely to simply write a check to bail out Dubai. Instead, he will probably force Sheikh Mo to make hard choices about developer Nakheel and other troubled enterprises. Some in Abu Dhabi will even want to see Dubai pay for its profligacy by turning over stakes in major assets. The two sides "will sit down and say this is sustainable, this isn't," says Hashem Montasser, Dubai-based managing director of EFG-Hermes, the leading regional investment bank. "I am sure there will be differences."

Until Dubai cleans up its act, it will be much harder to find the money needed to keep building the new highways, the public transit system, and other big infrastructure projects that have helped give it its edge. Already businesses in the emirate say it's tough to line up bank credit, and that won't ease anytime soon. "We are expecting it to be very difficult for

SAUDI ARABIA

Has become a world leader in petrochemicals via joint ventures with Shell and ExxonMobil. Expanding into plastics, steel, and auto parts. Has opened up investment banking in an effort to attract foreign capital and aims to build a half-dozen new cities with sprawling industrial parks and housing for hundreds of thousands of workers.

Dubai-based entities to raise money," says Farouk Soussa, a Standard & Poor's analyst in Dubai.

Given Sheikh Mo's missteps in the current crisis, he may find himself increasingly under the thumb of his neighbors in Abu Dhabi. It hasn't gone unnoticed that solo portraits of him on billboards in prominent locations across Dubai have been replaced by signs showing both the Dubai leader and Sheikh Khalifa.

Dubai may no longer be allowed to run an independent foreign policy. Sheikh Mo has long kept the city-state close to Iran—and tapped into its capital—while most other Gulf states see the Islamic Republic as one of their greatest enemies. And Abu Dhabi, which worries that the U.A.E. is losing its character due to excessive immigration, may push to tighten up on visas for visitors from Iran, Russia, and elsewhere. "The entire U.A.E. will gravitate toward Abu Dhabi," says Ian Bremmer, president of New York-based risk consultancy Eurasia Group. "That means Dubai will become more conservative socially and politically. Dubai's branding will be toned down."

"DON'T COUNT DUBAI OUT"

That toned-down branding means the emirate will surely rein in some of its excesses. Although the skyline and palm islands won't disappear, further over-the-top development will likely be put on hold. The city-state has "realized it's no longer about building the world's tallest tower," says Saud Masud, research chief for Swiss bank UBS. "Now it's about Dubai's legacy and its long-term future." And the crisis could help spur greater transparency—admittedly the weakest part of Dubai's economic model, says David Kirsch, an analyst at Washington-based consultancy PFC Energy. "This will put more pressure on Dubai to tighten up on regulations and improve governance," Kirsch says.

It is also hard to see Dubai losing its role as the region's leading business hub. It's true that Qatar's Doha, Abu Dhabi, and even the Saudi capital, Riyadh, are scoring some successes in attracting banking and other businesses. And with greater access to capital, they'll be able to close the infrastructure gap with Dubai. But few expatriates are going to want to settle in those places, which don't really want lots of foreigners and their unfamiliar ways anyhow.

While Dubai's current problems may be severe, the viability of its economic model remains sound. Demand for business services is down now, but it will surely bounce back once the credit crunch eases. "Don't count Dubai out," says Carlyle Group co-founder David Rubenstein. "It has world-class infrastructure, a high-quality talent pool, and will continue to be an important financial center for decades to come." Singapore, which has served as an inspiration for Dubai, learned from the crash of 1997-1998 and emerged much stronger from it. Dubai, too, now has the opportunity to take lessons from its mistakes and thrive once again. |BW|

—With Vivian Salama, Arif Sharif, Anthony DiPaola, Jason Kelly, Rochelle Garner, and Jonathan Keehner

DUBAI'S CRAZY QUILT OF ASSETS

By Jonathan Keehner and Serena Saitto

What Dubai World, the network of companies at the center of the emirate's mess, could put on the block

Sheikh Mohammed bin Rashid Al Maktoum wanted to turn Dubai into the next London or Hong Kong, a global hub for finance and tourism. To help execute his vision, the ruler relied heavily on Dubai World, the web of state-owned companies that includes everything from DP World, which operates 49 ports across the globe, to property developer Nakheel to investment arm Istithmar World. Unlike Abu Dhabi, the wealthy emirate to the southwest, Dubai had little oil production to fuel its efforts. Instead, lenders poured more than $100 billion into Dubai, at least $34 billion of which went to Dubai World.

Now, Dubai World is at the center of the mess in the emirate. Executives at the holding company are scrambling to renegotiate $26 billion in debt, which the government said it may not back. The clock is ticking: Roughly $3.5 billion of the debt comes due on Dec. 14. "Dubai World is an example of too big to fail but also too big to guarantee," says Rachel Ziemba, a senior analyst at Roubini Global Economics, a research firm. Dubai World declined to comment.

Regardless of the outcome, Dubai World may have to temper its global ambitions. Already, advisers are assessing the port-

(BOTTOM) KAMRAN JEBREILI/AP PHOTO

DUBAI'S WORLD

Here's a glimpse of what's inside the conglomerate's collection of businesses






CityCenter in Las Vegas: Dubai World got in at the peak of the credit boom

(TOP) ETHAN MILLER/GETTY IMAGES

folio to figure out what holdings can be sold to raise cash. The conglomerate likely will retain control of its infrastructure assets such as the ports, which are the emirate's crown jewels. But its global real estate and retail holdings may be auctioned off to the highest bidder. Abu Dhabi may go after some pieces in exchange for bailout money, say analysts.

"SOVEREIGN HALO"

The blurry lines between Dubai World, the corporate entity, and Dubai, the sovereign state, only make the restructuring process more unpredictable than that of a typical private company. In the end, the fate of Dubai World may be determined by the families that have governed the region for over a century, rather than investment bankers on Wall Street. "This may just come down to one sheikh calling another," says a senior adviser, who's currently working with Dubai World.

Dubai World's debt might never have hit such unsustainable levels if bankers had peeked behind the curtain. But most figured the emirate, or its neighbor Abu Dhabi, would bail out the businesses if they ran into financial trouble. The belief was so strong that both lenders and Dubai World executives referred to the "sovereign halo" around the enterprise. "Lenders weren't looking too hard into what entity was actually backing the debt," says Eckart Woertz, an economist at the Gulf Research Center in Dubai. "There was an implicit sovereign guarantee, which the government didn't discourage."

Internal documents only underscored that notion. Dealmakers that worked with creditors relied on a highly complicated, labyrinthine chart detailing Dubai World and all its related entities. "It's a bowl of spaghetti in terms of their corporate structure," says a top U.S. executive with extensive dealings in the region. "There are so many different companies and companies within companies." But the document pointed to one reassuring thing: The Dubai government owned 100% of Dubai World.

Lenders that did try to dig into the organization got a fuzzy picture. Dubai World didn't typically disclose its complete portfolio or provide financials to any of its creditors. "The banks understood that regular, fully audited reports from Dubai World were simply not available and not to be asked for," says Chris Turner, a former director of risk and asset management at Istithmar World. He estimates that Western banks gave Dubai World at least $15 billion in 2006 and 2007 without looking at the numbers. Turner, who was found guilty in absentia of embezzlement last month, maintains his innocence in the matter: "I fully intend to litigate and defend my actions in a court of good standing" outside of Dubai.

Even Dubai World didn't know exactly what it owned, according to Turner. In 2007 he started to build a list of all the real estate holdings at Istithmar World, including their current value. His team spent almost a year on the project, a task that Turner said should have taken a few months. Some loan documents and sale agreements were found in a file cabinet in an office that had been empty for months. "Being a risk officer there was like nailing jelly to a wall," he says. In a recent report on the debt restructuring published by Moody's Investors Service, the credit rating agency refers to the "limited availability of information regarding the consolidated

DP WORLD

One of the largest port operators in the world, it raised $5 billion in an initial public offering—the largest in the Middle East at the time.

PERELLA WEINBERG

Istithmar plowed $100 million into the advisory firm and its investment business, which were founded by ex-Morgan Stanley Vice-Chairman Joseph Perella and Goldman Sachs partner Peter Weinberg.

CITYCENTER

Dubai World and MGM Mirage are partners on this $8.5 billion Las Vegas development, which includes 67 acres of hotels and condominiums as well as a casino and a shopping center.

BARNEYS NEW YORK

In 2007, Istithmar spent nearly $1 billion on the retailer, which is struggling to pay its debt. Hedge fund Perry Capital, which owns some debt, has been approached by outside investors about a takeover.

W UNION SQUARE

Dubai World, which paid a pricey $1 million per guest room for New York's W Union Square, may lose control of the hotel when some of its debt goes to auction this month.

PALM JUMEIRAH

Nakheel, the Dubai World developer that risks defaulting on more than $3 billion of debt this month, built the palm-shaped island off the Dubai coast. The tourist destination features a shark-filled lagoon.



Palm Jumeirah: Developer Nakheel is at risk of defaulting on its debt

finances and debt burdens of state-owned enterprises."

Despite the lack of transparency, Dubai World had no problem borrowing money. British financial firms, including Royal Bank of Scotland and HSBC, arranged about $4.4 billion of the conglomerate's loans, according to a report by Bank of America Merrill Lynch. HSBC and Royal Bank of Scotland declined to comment.

OPPORTUNISTS ARE CIRCLING

Dubai World used the cash to fund a flurry of purchases. But dealmakers did so at the height of the credit boom, paying a premium for their global aspirations. The company shelled out $665 million for two New York hotels, the W Union Square and the Mandarin Oriental, whose sale prices each broke a local record of $1 million per guest room, according to Real Capital Analytics. It also has a 50% stake in CityCenter, a resort and casino development on the Las Vegas Strip that's opening this month. "They defined the peak of the real estate bubble," says Dan Fasulo, managing director of Real Capital Analytics.

Now pieces of the portfolio may be sold to pay off creditors. A group of outside advisers is working with Dubai World to assess the damage and figure out the next steps. For example, AlixPartners, a New York restructuring firm, is dealing with the various businesses owned by Dubai World on potential divestitures and layoffs. "The advisers will review Dubai World's portfolio, focusing on assets where there is still equity that can be sold as well as those that are burning through cash," says Fasulo. In a statement, the conglomerate said Port & Free Zone World (the parent of DP World), Infinity World Holding, and Istithmar World would be excluded from the debt restructuring because of the units' "stable financial footing."

CityCenter, the largest-ever privately financed construction project in the U.S., may be one of the easiest assets for Dubai World to sell. The $8.5 billion project has a relatively small debt load. That could make it more appealing to prospective buyers than other assets in the conglomerate's portfolio.

Some properties may be wrested from Dubai World's control. Troubled loans backed by the W Union Square will be auctioned this month. The winner could use them to gain control of the luxury hotel, according to Real Capital Analytics. The Mandarin, which is suffering from the slump in travel, may not have enough money to cover debt payments, say analysts. If the hotel does fall behind, pieces of the debt may be up for grabs, too.

Already, opportunists are circling. Private equity firms, such as Los Angeles' Colony Capital and Starwood Capital in Greenwich, Conn., are checking out real estate, according to people familiar with the matter. Hedge fund Perry Capital, which owns debt backed by Barneys New York, has been approached by investors, including Toronto department store Holt Renfrew, about a takeover of the retailer.

Dubai World will have to be cautious not to unload assets too quickly in the current environment. "Any desperate fire sale would further limit the amount of cash they can raise," says Ziemba of Roubini Global Economics. Regardless, Dubai World faces some steep losses on any sales. The company paid $1 billion for Barneys in 2007. Earlier this year bankers valued the retailer at less than half that.

Abu Dhabi likely will keep close watch on the process. The emirate, which has agreed to provide as much as $15 billion in financial support to Dubai, may offer additional funds to its profligate neighbor. There may be strings attached this time. Some analysts think the capital of the United Arab Emirates may ask for equity in some assets, cherry-picking those that fit within its own regional dreams. That could include parts of the infrastructure assets, including the ports. "Abu Dhabi is standing by Dubai, but it won't be giving a blank check," says Philip Lotter, a senior vice-president at Moody's. "It has drawn a line in the sand." |BW|

–With Beth Jinks and Pierre Paulden in New York and Vivian Salama in Dubai

Business Exchange

Read, save, and add content on BW's new Web 2.0 topic network

Thin-Skinned Sheikh

Even as Dubai has tried to build an image of itself as a modern, open city, its leadership has demonstrated a low tolerance for outside criticism. Several media outlets reported that authorities in the United Arab Emirates blocked distribution of the Nov. 29 edition of Britain's *Sunday Times*. The paper carried a story on the Dubai crisis, along with a photo montage showing ruler Sheikh Mohammed bin Rashid Al Maktoum adrift in a sea of debt.

To view the *Sunday Times* story, go to **http://bx.businessweek.com/dubai-business/reference/**

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CAN THIS MAN SAVE AOL?

Tim Armstrong may have the toughest job in media—trying to teach an old digital dog the new tricks that will make it relevant to users and advertisers

By Tom Lowry

Photography by Brad Trent



For Armstrong, the key to AOL's turnaround is original content

Tim Armstrong needs a new hip. Two decades ago the AOL chief executive absorbed a crushing hit on a high school football field. Over the years his discomfort worsened, and a few months ago his doctor told him that he should seriously consider a replacement. Armstrong, who is just 38, wasn't having any of it. He's too busy saving AOL, which on Dec. 10 will finally separate from Time Warner, bringing to a merciful end a dysfunctional marriage that lasted nine long years.

Armstrong may well have the most difficult job in media. Mention AOL, and people think: The Worst Deal of All Time! Ask them what AOL does nowadays, and most will say: I have no idea. "Tim needs to articulate the value of AOL," says Robert W. Pittman, a former AOL Time Warner chief operating officer. "He needs a strong selling proposition." Since leaving Google eight months ago to run AOL, Armstrong has busied himself coming up with one. It goes something like this: AOL is not some dot-com has-been selling Web access and e-mail. It's a digital media colossus with 80 Web sites churning out everything from personal finance advice to bedroom tips for women. With 100 million unique monthly viewers, Armstrong asserts, AOL has what it takes to lure blue-chip companies eager to reach multiple audiences with one ad buy.

Sounds great, right? And it might just work. But consider the challenges. Armstrong faces a landscape populated by giants, such as Yahoo!, Microsoft, and Barry Diller's IAC, and a slew of startups—all pushing their own content. Plus, Yahoo and Microsoft attract more eyeballs than AOL. And while Armstrong says content is at the heart of his strategy, AOL already tried that and failed. What's more, right now, advertising-supported content, according to one estimate, generates

only 30% of AOL profits. Meanwhile, AOL employees, having endured multiple layoffs and strategies over the past decade, are demoralized and weary of yet another makeover. So, yes, the hip operation can wait. "This is a challenge, I know that," says Armstrong, a first-time CEO. "We have to create a company that doesn't settle for mediocrity."

Armstrong's arrival at AOL marks the latest chapter for a company that over the past 25 years has gone through multiple permutations. When it was founded in 1985, it provided software for Commodore computers; a decade later it had morphed into America Online. AOL introduced millions of Americans to the Web, and the slogan, "You've got mail," embedded itself in the popular culture. As AOL's stock took off, hubris set in, and the boyish CEO, Steve Case, developed a burning ambition to acquire Time Warner, one of the world's most powerful media companies. The deal closed on Jan. 11, 2001, amid much talk of synergies. We all know what happened next: AOL Time Warner shareholders watched helplessly as $100 billion-plus in value evaporated.

STANDING OVATION

After that, AOL stumbled along, adopting one strategy only to jettison it for another. Meanwhile, the likes of Yahoo, Google, MySpace, and Facebook came to define the Web. Finally, earlier this year, Time Warner CEO Jeffrey L. Bewkes had had enough. And Bewkes, who had criticized the merger back when he was running Time Warner's HBO, set in motion the long-anticipated divorce. He hired Armstrong as CEO. The choice was widely applauded because during nine years at Google, most of them as head of U.S. ad sales, Armstrong had made peace with Madison Avenue, then deeply suspicious of Google's motives. By doing so, he helped turn the search giant into a $20 billion advertising juggernaut.

On Mar. 17, a rainy St. Patrick's Day, Armstrong made his AOL debut before 1,000 staffers packed into a large tent outside the original Dulles (Va.) headquarters. Case and former AOL Vice-Chairman Ted Leonsis spoke first. They took pains not to dwell on what might have been but on how Armstrong would transform AOL. Then Armstrong, an imposing six-foot-four, took the podium. The crowd, some wiping away tears, gave him a standing ovation. A few days later he reported for duty on the fourth floor of the Wanamaker Building in downtown Manhattan and got busy figuring out how to turn AOL into a 21st century media company.

AOL faces a classic business conundrum: The original enterprise (selling Web access) is dying, but the new operation (selling ads) isn't big enough to replace it. AOL still has about 5 million subscribers but is losing several hundred thousand a year. Recently, the company has made up for the loss in subscriber revenue by cutting costs. Then came this year's advertising drought. For the first nine months of 2009, AOL's revenues dropped 24%, to $2.4 billion, while operating profits shrank 34%, to $765 million. The picture doesn't get any rosier. Over the next three years, according to estimates from equity research outfit Sanford C. Bernstein, operating profits will continue to decline, by 10%, to $880 million. You can see why Armstrong is under enormous pressure to rev up advertising.

When Armstrong took over the corner office, he was shocked to discover that AOL had stopped doing the most basic things. Nearly three years had passed since it did any market research. In fact, AOL had been without a chief marketing officer for 12 months. "We were dark for a very long time," says a senior executive who is helping find a new CMO. In those first days on the job, Armstrong relied on his gut. He came to believe he needed to reach three kinds of people. There are old-timers who still use AOL e-mail and regularly visit AOL news, music, and entertainment sites. There are younger people who hang out at pop-culture sites like FanHouse, Stylelist, Spinner, or PopEater but have no clue that AOL owns and operates them. The last group are folks who simply gave up on AOL.



Levick was recruited to help sell AOL to Madison Avenue

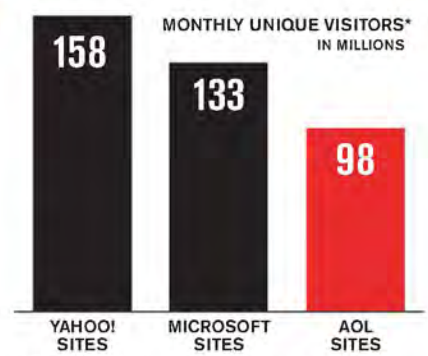
To find out how people perceive AOL, Armstrong hired ad giant Leo Burnett to conduct surveys among 5,000 people aged 18 to 65. Burnett found that most people are aware of AOL but lack strong feelings about it. About half said they didn't know what AOL did anymore. "AOL has the awareness," says Pittman. "It just has to drive out the fuzziness."

Armstrong went looking for answers. In his first 100 days, he visited 16 cities around the world. By his count, he has spoken with 10,000 people—employees, advertisers, investors, even people he meets at conferences. He has reached out to fellow executives. David J. Stern, a friend and commissioner of the National Basketball Assn., told him not to be afraid of experimenting. Mickey Drexler, the CEO of J.Crew, also head-



Wilson has hired seasoned journalists to write for AOL's sites

TRAFFIC WARS



*For October, 2009, including e-mail traffic
Data: comScore

quartered in the Wanamaker building, regularly drops by. He told Armstrong to listen to customers and workers.

Armstrong has become a student of corporate turnarounds. A favorite case study: Apple's resurrection. He asks employees to read a 1996 *BusinessWeek* cover story about Apple headlined "The Fall of an American Idol," a dour view of the company before Steve Jobs' return. Armstrong has taken much of his road map from the Apple turnaround, which he sums up as: "New products and services that people find necessary."

What he means by that is content—news, politics, sports, music. But isn't the world awash in content? Yahoo, arguably AOL's closest rival, has many similar sites. Yahoo and its ilk, however, are mainly aggregators, taking others' stuff and selling ads against it. Armstrong aims to stand out from the crowd by creating original content. A year ago, AOL licensed up to 80% of its content; today, the company says, it generates 80%. Bill Wilson, AOL's content chief, has exploited traditional media's implosion to hire seasoned journalists. Their expertise and voices, Armstrong believes, will enhance AOL's sites—and the brand. Each week some 30 AOL editors appear on TV and radio to talk about their areas of specialization. Of course, AOL once had access to Time Warner's original programming and journalism, and that didn't get it very far.

As local newspapers wither away, AOL is positioning itself as the go-to source for local communities. Its main vehicle is Patch.com, a collection of sites with a hyperlocal focus that AOL acquired in June. (Armstrong was an investor but agreed not to take a profit on the sale.) The sites, each operating under a single editor, offer local news and sports, restaurant offerings, and events. AOL operates 25 Patch sites in towns with populations of 15,000 to 50,000. It plans to have hundreds more up and running in the next year. The idea is to lure national advertisers keen to reach local consumers. So far, though, advertisers are mostly local—colleges, arts centers, florists, and so forth. And a lot of other players, including Topix, a venture by McClatchy, Gannett, and Tribune, are vying for the hyperlocal market.

E-mail may seem a sideshow these days, but AOL says it drives people to its sites, particularly since visitors see a page of headlines hawking AOL content whenever they sign on. While instant messaging remains popular, regular AOL e-mail lost 15% of its U.S. market share in the last year to the likes of

CHART BY ALBERTO MENA/BW

Yahoo and Google. To help reverse those trends, Armstrong recruited Brad Garlinghouse, a former Yahoo executive who helped the portal go from No. 3 to No. 1 in e-mail. One of the first things he did was reduce the advertising on AOL e-mail by 60% to eliminate the annoying clutter. He also ditched a bunch of obnoxious rules that had chased away many AOL e-mail users. When somebody canceled an account, for example, AOL didn't allow anyone else to use that name. Now it does. Also, AOL e-mail users could never put a period or an underscore in their addresses. Now they can.

Attracting eyeballs is just half the challenge. Armstrong needs to get advertisers to follow—and fast. To help sell the new AOL to Madison Avenue, Armstrong poached a Google colleague named Jeff Levick, calling him during a family vacation in St. Bart's to make his final and ultimately successful pitch. A former mergers-and-acquisitions lawyer, Levick brought with him valuable contacts, a clear sense of Armstrong's thinking, and a commitment to do for brand advertising at AOL what he had done for search advertising at Google.

Shortly after he started in April, Levick concluded AOL had too much advertising inventory—industry lingo for places to put ads. He and Armstrong agreed the oversupply was hurting the rates AOL could charge advertisers. So Levick did something unusual: He cut the number of ads on the home page from 10 to one. "You raise the quality," Levick says, "and charge a premium." Is it working? He isn't saying.

These days companies expect data proving that their ads are reaching the right people. Armstrong wants to go a step further by giving advertisers real-time information so they can tweak their messages on the fly. Once again AOL looked to a Google alum, this time Shashi Seth, whose job had been to wring as much money out of ads as possible. Seth gathered 55 computer scientists and ordered them to design algorithms that can do things like predict when demand for specific products and services peak. Intrigued by the technology, ad buyer Interpublic Mediabrands struck a strategic partnership with AOL in October. Interpublic will share resources and research, as well as take advantage of AOL technologies. "What we're seeing here is a very novel approach to advertising," says Quentin George, Interpublic Mediabrands' chief digital officer. "We're excited about how they are looking at consumer demand when it comes to content."

As his team works feverishly, burnishing old strategies and creating new ones, Armstrong's big push in the coming months will be selling the world on AOL, the brand. He doesn't believe it will happen with a flashy TV ad campaign. "We don't want to put lipstick on a pig," says one of his aides. Instead, Armstrong believes AOL needs to approach consumers with humility: Yes, the company lost its way, but now it has plenty to offer. How will he get the message out? "Listen," says Armstrong, "we have 100 million unique visitors every month, so that is a huge opportunity to spread the word."

CONVINCING INVESTORS

Unlike some of his predecessors, Armstrong seems unafraid to hitch sites to the AOL brand. "In the past, [our] services were like little speedboats racing away from the AOL name," he says. So does AOL's popular sports site FanHouse become AOL FanHouse? Still to be determined. "You may or may not see the AOL name on the title of our sites, but you will begin to see a more consistent effort to promote the AOL brand on the sites themselves," says Wilson. While some people wouldn't be turned off by having AOL attached to sites, it could hurt others. For example, consumers said if the Politics Daily site added the AOL name they might think the site is biased.

Armstrong is stressing all of this as he embarks on a 10-city U.S. road show. If consumers are apathetic about AOL, investors are bitter. Having been burned by the AOL Time Warner merger, money managers may require the hardest sell of all. Armstrong believes that simply being separated from Time Warner will put a lot of the ill will behind AOL. "Why would I buy AOL?" asks a large media investor. "It would largely be a bet on Tim, given what he was able to do at Google." AOL may never again be a $70 stock. And by some estimates, its market cap will be about $3 billion. That's not enough to make it into the Standard & Poor's 500, meaning AOL won't be able to tap the investors who buy that index. Still, Armstrong says AOL will have a chance to show Wall Street that it is the media model of the future. Needless to say, skeptics abound.

Armstrong knows he doesn't have much time to prove his case before AOL is written off as a legacy brand. That's why for now, as much as his old injury hobbles him on his worst days, the occasional acupuncture treatment will have to do. | BW |

WHERE ARE THEY NOW?

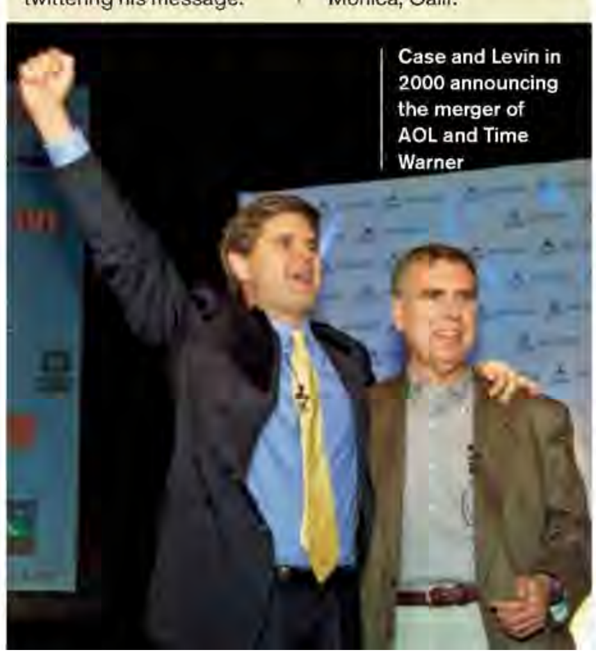
AOL CEO Steve Case and Time Warner CEO Jerry Levin were the architects of what many consider the worst deal in history. Within two years, Levin had left the company, and Case had relinquished his operating role.

STEVE CASE

Case, 51, runs investment firm Revolution, whose stakes include health-care and resort companies. He recently sold a unit, Revolution Money, to American Express for $300 million. Case and his wife, Jean, oversee the Case Foundation, which focuses on health care and the environment. He remains an apostle of the transformative potential of technology, relentlessly twittering his message.

JERRY LEVIN

After leaving Time Warner, Levin, now 70, transformed himself, getting a tan and shedding lots of weight. Levin was once described as a Machiavellian workaholic who became increasingly paranoid that Time Warner would be left in the dust of the emerging digital age. Today, he's a director of the Moonview Sanctuary, a holistic healing center in Santa Monica, Calif.



Case and Levin in 2000 announcing the merger of AOL and Time Warner

MIKE SEGAR/REUTERS



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Hordes of marketing "experts" are promoting the value of wikis, social networks, and blogs. All the hype may obscure the real potential of these online tools

BEWARE SOCIAL MEDIA SNAKE OIL

By Stephen Baker

Illustrations by David Plunkert

For business, the rising popularity of Facebook, Twitter, and other social media Web sites presents a tantalizing opportunity. As millions of people flock to these online services to chat, flirt, swap photos, and network, companies have the chance to tune in to billions of digital conversations. They can pitch a product, listen to customer feedback, or ask for ideas. If they work it right, customers might even produce companies' advertising for them and trade the ads with friends for free. Starbucks, Dell, and Ford Motor have all testified to the magic social media can create. ¶ But the same tools carry risks. Employees encouraged to tap social networking sites can fritter away hours, or worse. They can spill company secrets or harm corporate relationships by denigrating partners. What's more, with one misstep, one clumsy entrée, companies can quickly find themselves victims of the forces they were trying to master. Thousands of bloggers attacked Motrin last year because of an advertisement from the Johnson & Johnson brand they found demeaning to mothers.

Over the past five years, an entire industry of consultants has arisen to help companies navigate the world of social networks, blogs, and wikis. The self-proclaimed experts range from legions of wannabes, many of them refugees from the real estate bust, to industry superstars such as Chris Brogan and Gary Vaynerchuk. They produce best-selling books and dole out advice or lead workshops at companies for thousands of dollars a day. The consultants evangelize the transformative power of social media and often cast themselves as triumphant case studies of successful networking and self-branding.

The problem, according to a growing chorus of critics, is that many would-be guides are leading clients astray. Consultants often use buzz as their dominant currency, and success is defined more often by numbers of Twitter followers, blog mentions, or YouTube hits than by traditional measures, such as return on investment. This approach could sour companies on social media and the rich opportunities it represents. "It's a bit of a Wild West scenario," blogs David Armano, a consultant with the Dachis Group of Austin, Tex. Without naming names, he compares some consultants to "snake oil salesmen."

Critics complain that many of the new experts have adopted an orthodoxy that provides little flexibility for differing situations—or outcomes. Their pronouncements follow a rigid gospel: Be transparent, engage with your customers, break down silos. Yet these strictures don't always make busi-


PLUNKERT
SCALE
0
500
STATUTE MILES
DRY-FAST
CLEAR
VARNISH

ness sense. Adam Kmiec, director of interactive marketing at Marc USA in Pittsburgh, tells of a company he met with that got much of its revenue from the Defense Dept. and had allocated $4 million for social media. "What do you hope to get?" he asked them. Ultimately, the client decided the privacy-obsessed Pentagon may not be thrilled with a supplier publicizing itself through Twitter.

FURY VS. BUZZ

Scrutiny of the hype merchants is picking up. Rob Spencer, senior research fellow for idea management at drug giant Pfizer, mingles frequently with social media vendors and consultants as he looks for ways to amplify the company's brainpower. He urges caution. "You have to tread your way carefully and have your B.S. sensors up," he says. "I call them innovation hippies. 'Here's my book for free. Won't you hire me for $500 to run some workshops?'"

Social media consultants' own promotions can collide, on occasion, with those of their customers. Take the case of James Andrews, who was working early this year at the PR firm Ketchum. As a consultant, he helped companies such as Newell Rubbermaid, Monster Worldwide, and FedEx work out their strategies for blogs and the microblogging service Twitter. On landing in Memphis for FedEx meetings, he says he had an ugly run-in with a racist at the airport and twittered that he would "die if he had to live" in the city. The tweet produced an outpouring of blogged fury from FedEx employees and a fast apology from an embarrassed Ketchum. But for Andrews, the tweet generated buzz and may even have boosted his brand. "It helps me today," he says. "I use it as a case study. It creates authenticity." In June, Andrews left Ketchum to launch a boutique consultancy, Everywhere. He helps Macy's, CNN, and Jane Fonda promote their brands and monitor their audiences on Facebook, blogs, and Twitter.

Skeptics can draw from plenty of examples of social media experiments run amok. Consider Saatchi & Saatchi's ill-fated promotion for the Toyota Matrix. Targeting young men, a demographic known to resist traditional advertising, Saatchi's social media team last year created a campaign based on the pranks of the popular MTV show *Punk'd*. According to the plan, a prospective buyer of a Matrix would single out a friend to be the target of a prank. The promise: a bit of fear, a lot of laughs, and perhaps a groundswell of free marketing across Facebook, MySpace, and Twitter.

Amber Duick, one of the targets in the short-lived campaign, says she received a series of e-mails from a fictitious British soccer hooligan named Sebastian Bowler. He said he was coming to visit her and bringing along his pit bull. He had a MySpace page where he bragged about "drinking alcohol to excess" and participating in riots. One e-mail Duick received was a fake bill for damage to a hotel room wrecked by Bowler. He had left her e-mail address, the message explained, as his contact info. Duick filed a $10 million lawsuit in October and says that to protect herself from the oncoming Bowler, she slept with a machete by her bed. "She was terrified," says her lawyer, Nicholas Tepper.

In a statement, Saatchi and Toyota wrote that they would "vigorously defend against the claim," which is "entirely without merit." They said the plaintiff had granted "her permission to receive campaign e-mails and other communications from Toyota."

CAN CHAGRIN BE GOOD?

James Cooper, Saatchi's digital creative director, says social media, by their nature, are unpredictable, which makes them an easy target for critics. "Anyone who says 'This is going to work' is either lying or deranged," he says. He compares the risk model with venture capital, where one bet out of 10 might pay off richly, while the others struggle or even bomb. And he stresses the difficulty of measuring results. "If something's got 20 million hits on YouTube, that's a good thing," he says. "But what if half the comments are negative? ... I don't think anyone's got a long-term case study yet."

While the marketing consultants focus on buzz and engagement, their in-house colleagues are trying to use social media to change how companies operate. The goal of Enterprise 2.0, a descendant of the "knowledge management" movement in the '90s, is to reroute the information traveling through corporations, undermining rigid hierarchies. Tools from Microsoft's SharePoint, IBM's Lotus Notes, along with packages from newer

PROMISES AND PITFALLS IN SOCIAL MEDIA

Consultants employ catchphrases that often fail to distinguish between what works and what doesn't

	BENEFIT	RISK
Be transparent	Openness breeds trust and benefits the brand, bringing in friends and allies	There were good reasons companies kept some of this stuff secret
Listen to your customers	Companies can get valuable input on product successes and potential problems	Hiring staff to use Twitter or Facebook can be an expensive exercise for little substantial gain
Free is the future	Companies build communities around brands and find other ways to monetize products	They give away valuable products for free and watch revenues shrivel
Embrace personal brands	Companies urge employees to use social tools and build connections beyond corporate walls	They fritter away time on Facebook and Twitter—and possibly spill company secrets



companies such as Jive Software and Socialtext enable vast networks to share documents and work together on projects.

Yet the buzz around social media has led many companies to buy these systems before they're ready to put them to work. Jennifer Okimoto, associate partner at IBM Global Business Services, says many corporations took the plunge into social media and now are sitting on loads of uninstalled software. "I'm working with a company that has made huge investments" in social software, she says on a phone call from Switzerland. Yet only a small number of employees at the company use it. A Forrester Research study shows that despite buzz around Enterprise 2.0, less than 15% of the knowledge workforce makes use of internal blogs, wikis, and other collaborative tools. "E-mail is still dominant," says Ted Schadler, author of the report.

The economic situation is heightening the focus on accountability. "Companies no longer have fluff money" to experiment with, says Mark Turrell, chief executive of Imaginatik, a vendor of corporate knowledge management tools. "A lot of programs you launch and get good buzz. But now it's all about outcomes."

The debates over buzz are leading to confrontations among consultants. In late October, Marc USA's Kmiec, a little-known figure in the industry, launched a blog attack against Chris Brogan, one of the towering chieftains of social media. President of consultancy New Marketing Labs, Brogan is an object of considerable envy: He boasts 110,379 followers on Twitter, has co-authored a new social media best-seller, *Trust Agents*, and commands top dollar on the speaking circuit.

Kmiec wrote of Brogan: "He speaks well. He presents well.... Does that make him talented? Yes. Does it make him smart? Yes. Does it make him an expert? No." Kmiec asked Brogan for client case studies and metrics to prove his social media success. Responding on Kmiec's blog, Brogan dismissed the questions about his clients and social media metrics: "Is it an exacting marketing science? Not at all. Partly because it's so damned new that we're inventing the case studies while we're experimenting with what comes out of it. Are companies asking for more and more experiences with me to see if it'll work for them? Hell, yes."

DANGER OF A BACKLASH

Many argue that a fixation on hard numbers could lead companies to ignore the harder-to-quantify dividends of social media, such as trust and commitment. A Twittering employee, for example, might develop trust or goodwill among customers but have trouble putting a number on it. "There is this default assumption that return on investment is the correct measure for everything," says Susan Etlinger, senior vice-president at Horn Group, a San Francisco consultancy. "Everything needs to monetize within 12 weeks, so we can understand that we're successful. But frequently the thing they're measuring is misleading."

This can lead to confusion. The risk is that a backlash against the consultants' easy promises could reduce social media investments just as the industry takes off. Think back to the dot-com boom a decade ago. Soaring valuations were based initially on promise and hype. In early 2000, when investors started focusing on scarce profits, the market collapsed. But many companies drew the wrong conclusions. Believing the fall of a hyped market was a sign of the failed promise of the Internet, they drew back on Internet investments. This happened just as the technology was on the verge of living up to much of its promise, dominating global communications, transforming entire industries—and spawning social media.

The best way to avoid a similar backlash today is for social media's practitioners, including thousands of consultants, to shift the focus from promises to results. It may be the only way to convert the skeptics—and flush out the snake oil. |BW|

Business Exchange

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Are You Clued In?

The Cluetrain Manifesto of 1999, by authors Rick Levine, Christopher Locke, Doc Searls, and David Weinberger, set out the guiding principles of social media years before Facebook and Twitter existed. Thanks to the book's popularity among Web consultants, some of the declarations now sound clichéd, such as "Markets are conversations." But others still offer surprising insights.

For highlights from the book, go to **http://bx.businessweek.com/social-media-marketing/reference/**

Industry Unites in Recession

> "The challenges of the current economy offer a unique opportunity to push innovation to a new level. Wholesalers have become more creative, more strategic and more efficient, allowing us to do business smarter and faster, with greater result."
>
> **Rocky Wirtz**, chairman of WSWA and president of Wirtz Beverage Group

It's been a daunting year for the American people as we faced the worst recession since the Great Depression. Businesses have folded under and unemployment is at an all time high. Even the alcohol beverage industry has endured negative outcomes from the recession, although not nearly at the level of other industries. If the last year has taught us anything, it's this: the beer, wine and spirits industry is absolutely resilient to tough economic times. It's flexible and quick to adapt to changing consumer demand. As American consumers have morphed from the freer-spending, luxury seeking shoppers they once were into cautious, no-frills buyers searching for deals, the industry has changed too.

"The downturn of the U.S. economy the past year has brought new challenges to our industry, but I'm proud to say that our wholesalers, suppliers and retailers have showed continue strength in weathering the storm," said Craig Wolf, ceo of the Wine & Spirits Wholesalers of America (WSWA). "There's no other consumer product that I know of that has this type of variety, selection and innovation. It's a very consumer oriented system."

Now that we're in a recession, all three tiers are working together to bring value, which doesn't always mean price. It means a brand message, image or packaging - something that the consumer finds worthwhile and relatable.

There are signs that the economy is turning around but until employment rebounds, bars, restaurants and nightclubs (on-premise) are unlikely to see a dramatic improvement. In the meantime, the alcohol beverage industry has been key in driving consumer traffic. Restaurants, for example, are offering happy hour specials to draw in consumers, hoping they'll buy a few appetizers with their drinks or even stay for dinner. The on-premise is expected to show a little improvement in 2010 and even more improvement in 2011, according to data released by consulting firm Technomic Inc. in November.

The good news is that home consumption is on the rise and the off-premise business (retailers) is stronger than ever. Non-traditional off-premise establishments such as drugstores and even dollar stores are looking to the industry to help grow profits and increase traffic in their stores. In order to help these businesses and boost their own margins, wine, beer and spirits suppliers are putting more emphasis at retail stores with eye-catching packaging, displays and promotions. They're also introducing innovative new products and line extensions to meet consumer demand, such as pre-mixed cocktails, convenient packaging and new flavors.

The Wine & Spirits Wholesalers of America (WSWA) is holding the first annual

"State of the Alcohol Industry Briefing - Recession Tough, Recession Resilient."

Beginning at 5pm on December 10 at the prestigious National Press Club in Washington D.C., top industry executives will offer their insights on the industry, followed by a gala reception.


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057 A management fad from India
058 Korea: The trouble with *chaebol*
061 An unsung e-tailing powerhouse
062 A bid to keep SBA loans flowing
064 Radio Shack's wireless ambitions
065 Copenhagen: Good for business

MANAGEMENT & LEADERSHIP

Philanthropy the Microsoft Way

CEO Jeff Raikes is pushing the Gates Foundation to make big bets and demand measurable results

By Jay Greene

ACCRA, GHANA

It's lunchtime at the Ashongman School in Accra, the capital city of Ghana, and dozens of children in orange-and-brown uniforms file out to a serving table to pick up plates of jollof rice, a hearty dish with stewed chicken and tomatoes.

As the kids sit down, Jeffrey S. Raikes approaches them with the air of a waiter checking to see if his customers are enjoying their meal. "Do you like the rice?" he asks, as the kids stick their fingers into bowls to scoop up their meals in the dimly lit room. The kids nod, not entirely sure what to make of the stranger.

Raikes isn't there to gauge if the menu is a hit, nor can the chief executive of the Bill & Melinda Gates Foundation claim credit for the three-year-old Ghana School Feeding Program. Of the \$2.8 billion the foundation doled out last year, not a penny was spent on putting food in the mouths of these children. Instead, Raikes wants to learn why much of the rice eaten by the program's participants comes from Thailand instead of from farms a few miles away. If Ghana's farmers can find buyers for their crops, Raikes argues, they will have an incentive to make their land more productive and give this West African nation a more secure food supply. "The real opportunity here is to create a stabilized market," says Raikes. "You can use the school feeding program to bootstrap those efforts."

"Bootstrap" is a word that Raikes uses a lot. To him, it means creating a virtuous cycle in which suppliers can build businesses around long-term alliances with a strong partner. For anyone who has ever worked with Microsoft, as Raikes did for 27 years before retiring and joining the Gates Foundation, it's a familiar concept. The software giant created an ecosystem of partners that fed off Microsoft technology. Raikes is eager to import these ideas into the world of philanthropy. In October the foundation said it would donate \$15 million to the Alliance for a Green Revolution in Africa to help small farmers in Ghana and four other countries improve access to markets for their crops, among other things.



When Raikes left Microsoft, he was seen as its third-most-powerful executive

PETER DICAMPO

When Raikes, 51, took over the planet's largest philanthropy from Patty Stonesifer a little more than a year ago, he was an unconventional and somewhat controversial choice. Other than giving away much of the fortune he had amassed at Microsoft—his stock was worth \$400 million when he stepped down as president of the Business Division in early 2008—Raikes had no philanthropic pedigree. He lacked expertise in the Gates Foundation's core areas of interest: improving health in developing countries, eradicating poverty,



and improving high school graduation rates in the U.S. "He was an unknown quantity," says Vartan Gregorian, president of Carnegie Corp., one of the country's largest philanthropies.

UNDERSTANDING BILL

But Raikes has something few could match: a deep understanding of Bill Gates. That mattered to Gates. He wanted a chief executive who could adapt to his intense, often impatient style and bring a different approach to the world of philanthropy. "We looked for somebody who wants to learn because a lot of things we're doing are very novel," says Gates. "We're not just trying to do what's been done in the past." Raikes also had the chops to run a large and complex organization, having created the Microsoft Office word-processing, e-mail, and spreadsheet business, turning it into a highly profitable unit that brought in $19 billion the year he left.

Now Raikes is reshaping the $34 billion foundation, in the process giving it some of the characteristics that made Microsoft both revered and reviled. He's encouraging many of his 781 employees to place big bets on innovations that might someday make it easy to, say, detect malaria or tuberculosis quickly. He has also pushed to make sure that his people focus on funding projects that can yield measurable results. And while Raikes is making efforts to improve the foundation's image, he's clearly comfortable with using the organization's financial might to set its own agenda in trying to solve seemingly intractable problems.

Raikes' approach isn't likely to assuage concerns that the 12-year-old foundation's sway extends well beyond the funds it doles out. The huge pot of money it offers can shift the direction of research in a field. When it comes to global development, for example, the foundation spends millions on the creation of new seed varieties that are resistant to specific pests and diseases. That's a huge carrot for researchers,

keen to attract funding for their work. But it may come at a cost to simpler solutions like planting existing insect-repellent crops next to ones that are vulnerable. "They have a disproportionate influence on the direction of agriculture research," says Raj Patel, a visiting scholar at the University of California at Berkeley's Center for African Studies. "There's an opportunity cost to what Gates is doing. He can spend his money however he likes. But in doing so, he smothers [other] opportunities."

Like his boss, Raikes isn't cowed by criticism. Accusations that the foundation is overly influential, unaccountable, and arrogant are similar to the complaints that Microsoft weathered for decades as it dominated techdom. "The point here is not to get everybody to agree with our approach," Raikes says. "We have to have the courage of our convictions."

Yet he also recognizes the need to solicit alternate viewpoints, even if he doesn't follow them. Various governments sued Microsoft for antitrust violations in the late 1990s. Critics say the actions that led to those suits reflected an institutional arrogance. "At Microsoft during the early '90s, we didn't really feel like the politics associated with our industry should be on the radar," Raikes says. "I think it's very important to be in tune with what people are thinking about the foundation and make sure that we are viewed as a collaborative partner." Earlier this fall he asked the Center for Effective Philanthropy to conduct a survey of the foundation's current grantees to learn what it can do better.

Raikes acknowledges criticism of the foundation, but says: "We have to have the courage of our convictions"

Raikes is also willing to spar with Gates. Toward the end of summer, Gates sent Raikes a memo expressing frustration with the slow progress of one division at the foundation and suggested a reorganization. Raikes pushed back: "I said, 'So Bill, are you going to be the decision-maker, or am I, as the leader of this organization, going to be the decision-maker?' " Raikes recalls. Gates backed down. "If Bill gets intense," Raikes says, "it doesn't really ruffle my feathers."



Raikes with students at the Ashongman School in Accra, Ghana

Many who have worked with Raikes note that he's quick to put people at ease. Back in Ghana, a day after visiting the Ashongman School, he traveled to Ayisa, a tiny farming village where about 65 families live in mud huts with thatched roofs and no electricity. As he sat with the locals to talk about the local farm radio station the foundation has helped finance, he pointed out that he grew up on a farm in Ashland, Neb. He didn't mention that, while the Ayisa farmers scratch out what amounts to a living on plots of 35 acres or so, the Raikes family farm covers more than 2,500 acres. But he did note that his family's farm produces 8 to 12 tons of corn per acre, an eye-popping amount to the Ayisa farmers, who are lucky to get a ton per acre and often produce much less.

Raikes might have stayed a farmer had he not stumbled into the computer revolution as a student at Stanford University in the late 1970s. Back then, he learned how to program an Apple II to do complex economic modeling, something that helped land him a job with Apple. A few years later he moved to Microsoft, realizing his passion was in developing software. When he left, he was seen as the third-most-powerful executive behind Gates and CEO Steven A. Ballmer.

Now he's trying to apply the lessons of running a big organization to the foundation. "There was a bit of decision-making constipation, and that frustrated the employees," Raikes says. He posted something of a management manifesto on the foundation's internal Web site in July, calling for "decision-making hygiene." With any meeting, any strategy, any position paper, one staffer is in charge, he wrote. Gone are the days of trying to please everyone.

In his quest to improve both the perception and the impact of the foundation, Raikes has sought inspiration far and wide. Earlier this year he met with Norman Borlaug, the Nobel Peace Prize winner who was credited with creating the Green Revolution that brought new food production techniques to developing countries. Borlaug, who died just a few months after their meeting, was a brilliant scientist, Raikes says, "but the guy's success was even more related to the fact that he was a butt-kicker." Just like Borlaug, Raikes doesn't plan to let anything stand in his way. |BW|

PETER DICAMPO

MANAGEMENT & LEADERSHIP

From India, the Latest Management Fad

Companies are rushing to study *jugaad*, a method of meeting customer needs cheaply and fast

By Reena Jana

BANGALORE

On a recent afternoon, a dozen executives from companies including investment banks Rothschild and Goldman Sachs and tech research firm Gartner ringed a conference table in a brownstone on New York's Upper East Side. They were there to learn how U.S. businesses could develop products more cheaply and quickly by borrowing strategies from India. Speaker Navi Radjou, who heads the Centre for India & Global Business at Cambridge University, summed up his advice in one word: *jugaad*.

A Hindi slang word, *jugaad* (pronounced joo-gaardh) means an improvisational style of innovation that's driven by scarce resources and attention to a customer's immediate needs, not lifestyle wants. It also is fast becoming the latest buzzword in academic and management consulting circles, along with such terms as Six Sigma, total quality, lean, and *kaizen*, the Japanese term for continuous improvement.

But do companies really need to pay someone to tell them something as elementary as keep it simple? "Having a consulting industry built around *jugaad* is almost anathema to the word itself," says Robert Wolcott, executive director of Northwestern University's Kellogg Innovation Network.

Jugaad has a long history in India. Sandeep Vij, general manager of Cisco Systems in Bangalore and head of a unit that makes energy-monitoring systems, says a good example of *jugaad* is an Indian villager who constructs a vehicle to transport goats or cattle by turning an irrigation hand pump into a makeshift diesel engine for a wooden cart. Because *jugaad* essentially means inexpensive invention on the fly, though, in India it's sometimes equated with cutting corners, disregarding safety, or providing shoddy service.

GOOD ENOUGH FOR TATA

But for many companies, *jugaad* seems aligned with the times. Recession-slammed corporations no longer have money to burn on research and development. Likewise, U.S. consumers are trading down to good-enough products and services. Meantime, the Indian economy continues to plow ahead despite the global recession—it grew at a 7.9% clip in the third quarter—suggesting its executives have a winning strategy. *Jugaad* captures how Tata Group, Infosys Technologies, and other Indian corporations have gained international stature.

Already *jugaad* instruction is popping up in academia and at business consultancies. Prasad Kaipa, a former manager at Apple's in-house training university, uses *jugaad* in the courses he's teaching at Hyderabad's Indian School of Business. The University of Michigan's Ross School of Business, where high-profile Indian-born professor C.K. Prahalad teaches, has opened a research office near Infosys' headquarters in India so faculty can observe how Indian software companies come up with ideas. McKinsey consultants have begun talking up *jugaad* principles with clients, too.

At the same time, companies as varied as Best Buy and Oracle are employing *jugaad* as they create products and services that are more economical both for supplier and consumer.

Executives at Cisco, which opened what the San Jose company calls a second global headquarters in Bangalore in 2007, are also importing the Indian mindset as they meld teams of U.S. software engineers with Indian supervisors. "The innovation agenda in India is affordability and scale," says Wim Elfrink, Cisco's chief globalization officer, who moved to Bangalore in 2007. By any name, those attributes have worldwide appeal. |BW|



Vij employs *jugaad* at Cisco Systems in Bangalore

NAMAS BHOJANI

Do the *Chaebol* Choke Off Innovation?

South Korea's giant family-based conglomerates are thriving, but they may be crushing small companies

COUNTRY REPORT



Openbase CEO Song says *chaebol*-backed rivals have the upper hand

By Moon Ihlwan

SEOUL

Song Kyu Heon harbors no illusions about the strength of the *chaebol*, the family-controlled conglomerates that dominate South Korea's economy. Nonetheless, as chief executive of tech services company Openbase, Song was confident he could beat *chaebol*-backed rivals to win a multimillion-dollar deal to upgrade the computer systems at a Korean bank. His client roster, after all, includes Citibank, LG, heavy equipment maker Doosan, and dozens of other high-profile companies and government ministries. As a longtime contractor with the bank in question, Openbase knew its systems well, and a team of 20 engineers had been preparing a bid for a year. But in October, Song lost the deal to an affiliate of a top *chaebol*. "There's no such thing as a level playing field here," Song says in his fifth-floor corner office overlooking Tehran-ro, a street that's sometimes called Korea's Silicon Valley.

Song's tale is typical of small and midsize companies in South Korea. While the *chaebol* unquestionably have fueled the country's growth in recent decades, they're so powerful that they may be hampering innovation and threatening Korea's continued economic success. "With the *chaebol*'s deepening influence hurting fair competition with suppliers and startups, the country risks losing its economic dynamism," worries economist Kim Sang Jo of the Economic Reform Research Institute, an independent policy group.

A DIVERGING ECONOMY

In spite of the worldwide financial crisis, Samsung, Hyundai, LG, and other *chaebol* have recently reported impressive jumps in sales and profits. But not much of that prosperity has trickled down. While the big companies expand, "the rest of the Korean economy is still struggling," says Maarten Kelder, head of Asia-Pacific at consulting firm Monitor Group.

Korea's reliance on the *chaebol* is deepening. The top 10 exporters represented 43% of shipments abroad last year, up from 31% in 2001, according to the Korea Development Institute, a state-funded think tank. And the 50 largest companies—most of them *chaebol* affiliates—accounted for 38% of the country's total output in 2005, up from 30% a decade and a half earlier, the KDI reports. "The *chaebol* model has served well as a steppingstone for growth so far, but it is likely to be a stumbling block in the future," says Lee Kye Ahn, a former CEO at Hyundai Motor and now a prominent member of the opposition Democratic Party.

In tech services, for instance, most big conglomerates have subsidiaries that take care of their sister companies. With guaranteed profits from those contracts, these players can afford to undercut the likes of Openbase when

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competing for work with outside clients. "If not for the huge advantages and influence of the *chaebol*, Openbase could be a major player," says Baek Seung Gon, vice-president of eBest, a small tech-services player.

"DANGEROUSLY POWERFUL"

The list of the leading IT services companies in South Korea offers ample evidence of *chaebol* strength. Among the top 10 players, only No. 5, a subsidiary of state utility Korea Electric Power, isn't affiliated with a *chaebol*. It's the same story in advertising and logistics, with *chaebol* affiliates dominating the top 10 in both industries. "The *chaebol* have become so dangerously powerful that you must put a bridle on them," says Lee Dong Gull, a former financial regulatory official who now teaches economics at South Korea's Hallym University.

The reach of the *chaebol* is such that smaller rivals often work for them as suppliers, so those companies are afraid to speak up. More than a half-dozen executives declined to talk on the record about their relations with the *chaebol*. And those who agreed to speak were reluctant to give much detail. Openbase, for instance, works as a subcontractor for *chaebol* tech-services players, so CEO Song is unwilling to name either the bank with which he was trying to get a contract or the rival that beat him.

Other small Korean companies fret about the power of the *chaebol*. A supplier of interior parts for Hyundai Motor, for instance, says that while the automaker is reporting record earnings, he is barely breaking even. "During fat years the big guys [hog] all the profits," says the supplier's general manager, who asked that his name not be used for fear of retaliation from Hyundai. "They let us get by but never allow us to have a big enough margin to invest in research." Hyundai counters that it treats its suppliers fairly.

Another problem is that the best and brightest university grads want to work for the *chaebol*—starving startups of talent. Less than 10% of the 4,000 students who graduated this year



Hyundai Motor is booming, but a supplier complains his margins are tiny

SEOKYONG LEE/BLOOMBERG

from Yonsei University in Seoul, for instance, got jobs at small companies. And officials at Yonsei, one of Korea's top three schools, say most of that 10% would have preferred jobs at the *chaebol*. "I've never thought of seeking a job elsewhere," says Kang Hye Jeong, a 27-year-old marketer at Samsung's handset unit, who says she has visited more than 20 countries in her four years at the electronics giant. "You couldn't expect such global experience at a smaller company."

HOW TO PLAY IT 068

Given the difficulty of standing up to the *chaebol*, financing is tough for startups. Brokerage Korea Investment & Securities recently failed to raise a $90 million fund for tech startups, and the main index of Kosdaq, the South Korean equivalent of Nasdaq, has fallen 84% since its peak in March 2000, while the benchmark Kospi index of larger companies has risen 68%.

Korean policymakers acknowledge the need to help the small fry compete with the giants on a more equal footing. Seoul in August earmarked $7.5 billion to finance joint research between universities and smaller companies in new growth areas such as renewable energy. "The policy focus for future growth will be on encouraging competition by liberalizing markets and helping smaller firms create intellectual property," says Noh Dae Lae, deputy minister at the Ministry of Strategy & Finance.

Ultimately, the *chaebol* may benefit from such initiatives. If the giants squeeze small suppliers so hard that they can't invest in innovation, the *chaebol* will hurt their own competitiveness, so programs that strengthen smaller companies will likely help South Korea's conglomerates, says Lim Kyung Mook, a researcher at the Korea Development Institute. "The important task is to begin attracting talent and funds to startups," Lim says. "We need a better balance between the conglomerates and smaller companies, a business environment where startups can grow big enough to compete with the big guys." |BW|

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STRATEGY & COMPETITION

Who's Minding the Store for Toys 'R' Us

GSI, the biggest e-commerce company you've never heard of, is running major Web businesses for retailers

By Burt Helm

Parents who shop on Toysrus.com this holiday season likely won't know that a company called GSI Commerce is managing the orders behind the scenes. But GSI is ubiquitous: It runs retail Web sites for some 100 brands, including the NFL, Bath & Body Works, Ralph Lauren, Aeropostale, and Toys "R" Us. All told, the company processes $3 billion in annual sales, from which it takes a commission.

GSI Commerce, based in King of Prussia, Pa., may be invisible to shoppers, but it's attracting attention on Wall Street. Over the past 12 months the company's stock has shot up 236% as its founder and chief executive, Michael G. Rubin, has gone on an acquisitions rampage. GSI, which lost $16.9 million on nearly $967 million in revenue in 2008, now has $242 million in debt. While the company has been profitable in the past, analysts expect it to lose money again this year. But the 37-year-old Rubin, who practically grew up running the place and saw the company through the 2001 dot-com bust, insists he has no choice but to keep growing. His goal is to make GSI one of the biggest Web retailing companies in the world. Skeptics wonder if the bets will pay off.

Many chief executives say they feel personally enmeshed in their company's fate, but few can say they've felt that way since age 12. That's when Rubin started the business that eventually became GSI, adjusting and fitting customers' skis out of his suburban Philadelphia basement. By age 22, he had enough cash to acquire two small shoe brands, which he sold through major sporting goods chains.

It wasn't until 1998, after hearing his sporting goods clients worry about the complexity of selling products online, that Rubin says he recognized his "huge opportunity." While his footwear brands would never rival Reebok or Nike, e-commerce was still anyone's game. "It was the first time I could be No. 1 in a market," he says.



Founder and CEO Rubin is unperturbed by short sellers in GSI stock

Rubin sold the footwear brands and, under the name Global Sports, persuaded his clients to let him manage their Web stores.

Most of GSI's clients are traditional retailers who ring up only 5% to 10% of their sales online. But Rubin believes that online sales will become a bigger part of their businesses and that retailers will still pay someone else to handle plenty of complex Web tasks. So in addition to opening offices overseas, Rubin has bought an array of Internet service businesses over the past two years, including an e-mail marketing company, an affiliate marketer (it recruits people to drive sales to clients' sites in return for a commission), and a Web design firm, which he uses to bolster an interactive marketing agency. On Oct. 27, GSI agreed to spend up to $350 million in cash and stock to acquire Retail Convergence, which owns the sites Rue La La and SmartBargains.com, giving clients an easy way to liquidate slow-moving inventory.

Customers seem satisfied. Greg Ahearn, e-commerce czar at Toys "R" Us, worries about GSI's expansion plans. But that didn't stop his company from re-upping with GSI through 2019. General Nutrition Centers, Ralph Lauren, and Dick's Sporting Goods have renewed their contracts, too.

All the same, trouble may be brewing on Wall Street. After GSI's heady performance this year, short sellers are gathering: A full 15% of shares available for public trading have been sold short. Rubin is unperturbed. While GSI will continue to lose money, he says, it remains cash-flow positive. "We think of ourselves as the worldwide leader of e-commerce for consumer brands," says Rubin. "And this is just the first quarter of the football game." (BW)

BILL CRAMER/WONDERFUL MACHINE

A Short-Term Crunch For Small Business?

The Administration is eager to open up SBA lending further, but the gears of Washington grind slowly



Johnson: "Businesses that already have good funding" will benefit

SMALL BIZ

By Jeremy Quittner

By extending some of the stimulus provisions that apply to Small Business Administration-backed lending and by giving community banks access to Troubled Asset Relief Program funds, bills in both the House and Senate could improve small business' access to financing in 2010. But it may be impossible to reconcile the two bills quickly enough to prevent SBA lending from heading into another tailspin. "We are in a very fragile economy," says James Ballentine, head of small business policy for the American Bankers Assn. "If the [stimulus] money is exhausted and can't be restored, we will see a sizable drop in SBA loans." On Nov. 24, the SBA announced that stimulus funding for SBA lending had dried up.

Both bills follow the Obama Administration's Oct. 21 announcement it wants to let community banks use funds from TARP to lend to small businesses. The Administration also seeks to raise the cap on the SBA's flagship 7(a) loans to $5 million from $2 million, and to boost the limit for the SBA's 504 expansion loans to $5.5 million from $4 million. The microloan cap would jump to $50,000 from $35,000. While Treasury is in charge of TARP, Congress must O.K. changes to SBA loan programs.

Since March 2009, about $375 million in stimulus has been used to increase government guarantees on 7(a) loans to 90% and eliminate borrower fees on both 7(a) and 504 loans. Both houses are discussing extending that funding. The SBA says stimulus money has so far supported about 36,000 loans, totaling $14 billion. Before those funds were available, 7(a) lending had dropped about 50%. Based on current loan volume, SBA spokesman Jonathan Swain estimates it would take about $50 million to $55 million more per month to continue the initiatives.

Still, some business owners don't see much to cheer about. John Johnson, president of Frankfort (Ill.)-based Graceful Concepts & Images, a three-employee interior design company with $650,000 in sales, says he has applied to 10 institutions in the past year, half of them community banks, seeking about $150,000 for gap financing and to buy inventory for contracts he's signed. "The President is so committed to getting money into the hands of small businesses, but ... it is going to assist businesses that ... already have good funding sources," Johnson says. He says bankers have told him his company lacks adequate cash flow, and at 620 his credit score isn't high enough for a loan.

Meanwhile, some community bankers say they have no desire to tap into TARP. Gilles Gade, chairman of Cross River Bank in Teaneck, N.J., says the terms are likely to be too onerous. The three-year-old bank, with $80 million in assets, wants to move aggressively into small business lending. It has a $10 million portfolio of commercial loans to local small businesses, and Gade says he plans to increase that to $25 million in the next year because demand is high. Although he acknowledges that the final regulations have not been written, Gade expects the added oversight "would be very burdensome for small banks like us." | BW |

KEVIN MIYAZAKI/REDUX

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RadioShack's Wireless Ambitions

Will its shift toward selling wireless gear boost the chain's flagging same-store sales?

By Matthew Boyle

Long the humdrum home of extension cords, TV antennas, and battery-powered toy cars, RadioShack has spruced up its image just in time for the holidays. It's making a big push into wireless products and has launched fresh ads featuring its new moniker, "The Shack."

Investors have noticed, lifting the share price of the Fort Worth retailer 60% so far this year. But CEO Julian C. Day, a native of Yorkshire, England, will need all the stamina he can muster to win the battle for wireless customers.

While the Consumer Electronics Assn. expects Americans to spend an average of $222 on gadgets this season, about 8% more than last year, the competition for those dollars has become fierce. Best Buy has launched a specialty store for wireless products called Best Buy Mobile. Wal-Mart Stores is slashing wireless prices there, too. The individual carriers, not to mention Apple, also have their own stores.

Day says his strategy is already bringing results. "The new positioning is getting through to consumers," he says, while strolling through a store in New York's Manhattan Mall in mid-November. Kim Dixon, senior vice-president for consumer sales at Sprint, says sales of phones with Sprint coverage plans are up by double-digit percentages at RadioShack, adding that "we've been wowed by our performance there."



Day has also picked up T-Mobile USA, and Apple's iPhone is now in 250 RadioShack stores and slated for a national rollout next year. "People used to walk into the store, ask if we had the iPhone, and when I said no, they'd walk out," says a Manhattan store employee.

CEO Day has been on a cost-cutting rampage. Now he has to go up against the likes of Wal-Mart and Best Buy

The new positioning was long overdue, analysts say. Day, 57, spent the previous three years on a cost-cutting rampage, closing nearly 500 stores. He even sold off the company's potted plants to employees (for $5 apiece), rather than pay to maintain them. Revenue declined from over $5 billion in 2005 to around $4.2 billion last year. Same-store sales, a key barometer of a retailer's health, declined for three straight years at its 4,470 company-owned stores and 450 kiosks, located mostly inside Sam's Club warehouses, part of Wal-Mart. Now, Credit Suisse analyst Gary Balter believes wireless will grow from about a third of sales to half, in 2010.

Still, it's hard to ignore the threat from competitors. Best Buy is rapidly rolling out small, standalone mobile stores, with 68 of them already in place. Scott Moore, Best Buy Mobile's vice-president for marketing, says RadioShack can't offer the same level of customer support. But Day has beefed up employee training to bring workers up to speed on product features. "We are every bit ready to compete with Best Buy and Wal-Mart," he says.

As RadioShack pushes wireless front and center, old standbys like soldering irons and phone cords have been shunted to the back of The Shack. (No, the official name hasn't changed, but this variation is being used in all the advertising.) While it made sense to slice "Radio" from the name, the re-branding has not yet won over experts like Alan Wolf, senior editor of electronics industry publication *Twice*. "It's ambiguous and, if you think about it, none too flattering," he says.

Day will ultimately be judged by same-store sales, which declined 2.9% in the third quarter. Wrapping up the store tour, Day won't predict when sales will grow again but says "there is a mood of optimism out there." |BW|

–With Christopher Palmeri

ROBERT NEUBECKER



ROBERT WALLIS/PANOS

A solar engineer in Rajasthan, India: Global competition is likely to heat up

INNOVATION & TECHNOLOGY

Why Copenhagen Will Be Good for Business

Progress toward a climate deal would tip the balance toward renewables and create opportunities

By John Carey

When the delegates at the climate summit in Copenhagen need to call home, they can do so in style. Cisco Systems is outfitting four rooms in the city's Bella convention center with a giant-screen teleconferencing system, enabling officials to confer face to face with counterparts in 100 places around the world. The donation is not entirely altruistic. It's a demonstration of how Cisco's products can substitute for business travel, slashing carbon emissions. Technologies such as these "have the power to transform how the world manages its energy and environmental challenges," says Laura K. Ipsen, Cisco's senior vice-president for global policy.

Most of the attention at the climate meeting, which starts on Dec. 7, will be focused on government negotiations. With President Barack Obama pledging that the U.S. will cut its greenhouse gas output 17% by 2020 and China agreeing to improve its energy efficiency, the summit is now expected to make progress toward global limits on emissions. Cisco's presence, however, illustrates a powerful subtext for the summit: Putting the world on a greener path can be good for business.

TECH BAZAAR

More than 160 companies are showcasing solar panels, green buildings, and other wares at a "Bright Green" technology bazaar in Copenhagen. That includes a delegation of U.S. businesses led by Commerce Secretary Gary Locke, who hopes to raise exports and U.S. competitiveness. "Clean energy may be the greatest economic opportunity of this century," Locke says.

How fast the markets grow, however, depends on government policies—and government money. On Nov. 24 the Obama Administration jump-started transformation of the U.S. electricity grid, awarding $620 million for smart meters and other technologies. French giant Alstom is proving it can capture carbon emissions from coal-fired power plants, armed with government funding for projects in Poland and West Virginia. IBM's business of helping companies measure their carbon footprints is growing now that the U.S. will require emissions to be reported. And solar panel companies are salivating over India's plan, announced on Nov. 23, to install 20 gigawatts of solar power by 2022. "India is potentially a tremendous market that we're working on already," says Steven P. Chadima, vice-president of Suntech Power Holdings.

The cleantech business will get a boost from two steps expected from the Copenhagen process. First, the meetings will encourage further use of cap-and-trade systems, raising the cost of polluting. That will tip the balance toward renewable power and energy efficiency, and, thanks to trading, enable emissions reductions to be sold for revenue. The second step will be a commitment that industrialized countries will start transferring billions of dollars a year to developing nations to help them become more efficient. That could touch off a global competition to sell, say, solar panels and carbon-capture technologies to India, or wind power to Brazil.

While business hopes to profit from Copenhagen, it also has a message for the politicians, especially in the U.S. "It's very important that they understand we have practical solutions to solve the problem of CO_2 in the atmosphere," says Philippe Joubert, president of Alstom Power. Adds Gregory H. Kats, senior director of cleantech investor Good Energies: "It will be pretty hard to argue that emission caps will tank the economy and hurt business when there are a lot of companies saying this is a huge business opportunity." BW

Simple Truth: Investment costs count

The lower the costs **the more you keep.**



Many investment firms call themselves low cost. But, the truth is, many of them charge about six times as much as Vanguard.* This can cost you thousands of dollars. For instance, over twenty years, if you invest $10,000 a year with an average return of 8% before expenses, you would keep about $58,000 more with the lower cost fund! And the longer you invest, the greater the savings. It's your money. Keep more of it. Vanguard. The simple truth about investing.**

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Visit www.vanguard.com/simpletruth, or call 877-527-4941, to obtain a prospectus, which includes investment objectives, risks, charges, expenses, and other information; read and consider it carefully before investing. Investments are subject to market risk. *Source: Lipper Inc. as of 12/31/2008. **Based on 2008 industry average expense ratio of 1.19% and Vanguard average expense ratio of 0.20%. Hypothetical example does not represent any particular investment. Simple Truth, The simple truth about investing, Vanguard, and the ship logo are trademarks of The Vanguard Group, Inc. ©2009 The Vanguard Group, Inc. All rights reserved. Vanguard Marketing Corporation, Distributor.

068 How to Play It: Korea
070 Life Management: Estate planning
073 Inside Wall Street

MONEY REPORT

BUYING CHINA'S CONSUMERS

Investors hoping to cash in on the growing strength of Chinese consumers might consider the Global X China Consumer Exchange Traded Fund. Launched by New York asset manager Global X on Dec. 1, the ETF is the first designed to tap into what could become a big driver of the world economy. On Nov. 13, China President Hu Jintao said China will take "vigorous" steps to boost domestic demand. "The next wave of global growth is going to come from developing a consumer base in China," says Bruno del Ama, CEO of Global X. Retail and food companies make up more than 50% of the fund, which charges 0.65% in fees and other expenses. Global X also launched an ETF to track China's industrial sector. Through Nov. 30, China's Shanghai Composite stock market index returned 78%—some 48% below its all-time October 2007 high. *–Tara Kalwarski and Veronica Navarro Espinosa*

BREAKDOWN OF GLOBAL X CHINA CONSUMER ETF BY INDUSTRY*



*Numbers do not equal 100 due to rounding
Data: Global X Management Co.

CHART BY ALBERTO MENA/BW

PRECIOUS METALS

GOLD KEEPS ON GOING

After hitting a bump in the road, gold continues its recent surge. Its price fell by as much as 4.2% on Nov. 27 as nervous investors, spooked by Dubai's attempt to postpone debt payments, rushed to the safety of the U.S. dollar. (Since gold is bought and sold in dollars, gold and the dollar tend to move inversely to one another.) The drop wasn't as drastic as it first appeared, says Barclays Capital technical analyst Jordan Kotick. Gold bottomed at $1,137 an ounce, well above $1,127, the point at which technical analysts say demand will outweigh supply, and finished the day at $1,177.63, down just 0.9%.

On Dec. 1, gold traded at $1,201.63, an all-time high. It is poised to move higher. During breakouts that began in 2005 and 2007, gold shot up 54% and 60%, respectively. Its gain since Oct. 2, when the current rally began, is just 19%. Kotick expects it to reach $1,300 by March and says it could hit $1,500 by 2011. *–Kyoungwha Kim and Ben Levisohn*

19%
Rise in gold since its rally began
Data: Bloomberg, as of Dec. 1

STOCKS

HEDGE FUNDS BOOST BETS

Hedge funds are shoveling money into stocks as individuals make a quick exit, a sign to professional investors that the Standard & Poor's 500-stock index should extend its gains. About $37.3 billion has left U.S. mutual funds since August, says the Investment Company Institute. In the third quarter, hedge funds boosted bets to the highest level since the end of 2007, data compiled by Goldman Sachs, industry consultants, and Bloomberg show.

ICI numbers show individuals took $21.4 billion more out of equities than they added and put $312.8 billion into bonds in 2009 through Oct. 30. Over that period, says Morningstar, bear market and long-short mutual funds, designed to profit if stocks fall, got a record $10 billion from retail investors. (Asset managers have opened 19 long-short funds so far in 2009, the most in a year.) By contrast, Goldman Sachs data show hedge funds upping stakes in stocks by 21% in the third quarter. ***-Lynn Thomasson and Mary Childs***

Do the *Chaebol* Choke Off Innovation?

(FROM PAGE 058)

By Tara Kalwarski

South Korea, with a GDP of nearly $1 trillion, is more of a developed market than an emerging one. But while some companies that design financial indexes classify the country as developed, others, like MSCI, still count it as emerging. For investors, South Korea can offer the best of both worlds: big returns typical of emerging countries but with the reduced risk of more developed nations.



Data: Bloomberg

KOREAN FLAVOR

These funds offer exposure to Korean companies such as Samsung and SK Telecom.



Schwab Fundamental Emerging Markets Index SFENX



Fidelity Southeast Asia FSEAX



Goldman Sachs Asia Equity GSAGX

A PURE PLAY

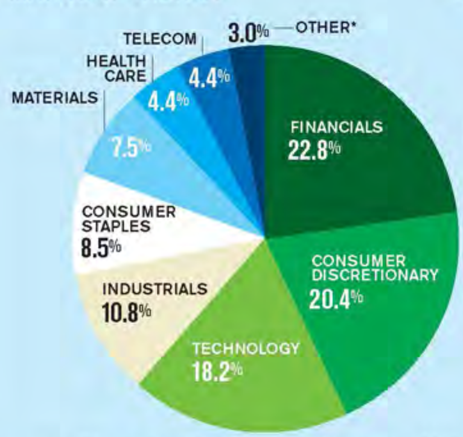
Matthews Korea Fund is the only mutual fund that focuses exclusively on South Korea. Since its inception in 1995, it has outperformed the Korean stock market by 3.4% a year. Right now, it's emphasizing industries that stand to benefit as Korea's economy continues to mature.

TOTAL RETURN*

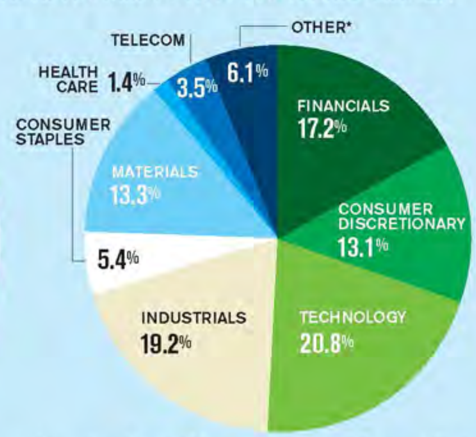


FUND VS. BENCHMARK

MATTHEWS KOREA



KOREA COMPOSITE STOCK PRICE INDEX



CHARTS BY DAVID FOSTER/BW

*As of Sept. 30; multiyear returns are annualized **Includes energy, utilities, and cash holdings Data: Morningstar; Matthews International Capital Management, FactSet Research Systems

If A+ people A+ knew A+ our A+

credit A+ rating, A+ Sun Life A+ Financial

would A+ probably A+ become A+ a

household A+ name. A+ But A+ bragging

just A+ isn't A+ us.

We've maintained an A+ credit rating* for financial strength through good times and bad. And not once have we asked for any government bailout money. It's time to get to know Sun Life Financial.

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slpc 21036 (10/09) (exp 4/11)

FINANCIAL PLANNING

BEYOND OZZIE AND HARRIET

By Christopher Farrell



Hamilton and Erickson are drawing up trusts to help protect them financially

JONATHAN CHAPMAN

A few clicks of a television remote reveal a lot about the American family in 2009. In place of the images portrayed in the 1950s shows *Father Knows Best* and *The Adventures of Ozzie and Harriet,* we now have *The New Adventures of Old Christine*, which follows the travails of a single mother, and *Modern Family*, which includes a male couple who adopt a baby girl from Vietnam.

America is a more diverse country, and financial planning is evolving to meet the needs of a more disparate group of clients. Many basic concerns, such as the need to start saving early for retirement, are the same for traditional and less conventional couples. Other problems are quite different, including the treatment of Social Security payments. Here's how some couples are addressing crucial financial issues.

GAY PARTNERS

Gay couples across the country face financial planning challenges, especially since state laws treat gay marriage so differently. For instance, like any married couple, David Hamilton and Bernie Erickson want to protect each other financially in case of one of them dies or gets seriously ill. Hamilton, a music professor at Concordia College in Moorhead, Minn., and artistic director of the Fargo-Moorhead Opera, lives in Fargo, N.D. His partner is a vice-president for Macy's in Fargo. They married in Canada in 2006, but North Dakota doesn't

recognize gay marriage. The two own a home together. They also carry life insurance on each other and for children they have from previous marriages, whom they want to protect as well.

To deal with situations like this, gay couples typically rely on trusts more than conventional couples do. There aren't real tax advantages, but it's a legal device that protects the partners and is hard for family members to contest. Hamilton and Erickson have hired an attorney to draw up a trust for each of them, which will include their home, vehicle, and other assets. "It's a more secure way of making sure our wishes will be followed," says Hamilton.



Another major financial and emotional issue in the gay community involves income and asset inequality within marriage. A partner with little income and assets is highly vulnerable. For instance, Social Security doesn't recognize gay marriage. Neither does federal law. So in a gay marriage, if the surviving spouse is the low earner, he or she doesn't benefit from the high earner's Social Security payments. If a high-earning woman and a low-earning man divorce after being married for more than 10 years, the divorced man (if he doesn't remarry) will benefit from his former spouse's higher Social Security payments.

A common solution is for the wealthier partner to gift the maximum every year to the spouse. (For 2010, that's $13,000.) Over time these irrevocable gifts can allow the less-well-off partner to build substantial assets. "I really push clients to think through sharing risk equally," says Ann Viitala, a Minneapolis attorney who specializes in working with nontraditional families.

SINGLE MOM

Many single moms struggle financially, even if they get child support and alimony. "Finances are so far down the list of things to do," says Julie Schatz, a certified financial planner (CFP) in Menlo Park, Calif. "It's always an 11th-hour scramble with money."

Rachel Swardson-Wenham couldn't agree more. She had her third child and soon after launched a business with $17,000 in 2008—just as her husband left her. She lost her home to foreclosure and moved into a much smaller place. Money is tight. She sold her wedding ring to meet expenses for her business, Go Home Gorgeous, which offers a spa-type experience for women in the hospital after giving birth.

For single parents, life insurance is the big priority. A term policy that lasts 15 to 20 years or until the children are grown is more than adequate. For instance, a healthy 40-year-old woman in Massachusetts could get a 20-year policy with no change in annual premium payments for $700 to $900 a year, or $58 to $75 per month. Also crucial is a will that provides for guardianship of children.

Long-term disability insurance is important as well. It's really paycheck protection, or more accurately, partial paycheck protection. Disability insurance replaces a portion of your income if you can't work because of an illness or injury. A typical group plan policy is cheap as part of an employee's benefits package, costing the employee nothing to a few dollars a month. An employer's policy usually replaces up to 60% of salary, and highly compensated employees often pay for supplemental cover-

FAMILY FORUMS

A number of Web sites focus on the finances and careers of gay and lesbian couples, domestic partners, single parents, and other family arrangements.

WWW.NOLO.COM

The legal self-help organization offers financial information for all kinds of couples. It covers everything from how gay couples can take care of each other's finances when one partner is incapacitated to tax breaks for single parents.

WWW.GFN.COM

The site, launched in 1998 by the first openly gay member of the New York Stock Exchange, has evolved into a comprehensive financial portal for gay couples. It covers many personal finance topics, such as prenups and living trusts for gay couples, as well as career and health news and advice.

WWW.STEPFAM.ORG

The National Stepfamily Resource Center is a division of Auburn University's Center for Children, Youth, & Families. Its mission is to act as a "clearinghouse of information" that disseminates best practices for couples and children in stepfamilies on a wide range of issues, including handling stepfamily money and the effects of remarriage on children.

age offered through their employer or buy an individual policy to boost coverage by an additional 10% to 20%. It's much more expensive to buy an individual policy if your employer doesn't offer one—usually about 3% of your annual salary.

After paying those bills, finding the money to keep saving may seem difficult. But Rick Brooks, a CFP with Blankinship & Foster in Solana Beach, Calif., urges single mothers to try. He recently put together a plan for a friend who is a single mom. Working through a temp agency, she had had three jobs over three years. He encouraged her to set a goal of putting aside enough money to meet two years of expenses. "From my perspective, unless you have a very stable job, single moms really need to focus on building up rainy day funds and paying down debt," says Brooks.

TRADITIONAL COUPLE

The rules of thumb for traditional couples are often inadequate for dealing with blended families, older boomers with young children, and marriages with a significant age difference between partners. For instance, for couples who are about the same age, it often makes sense to reduce sharply or even eliminate life and disability insurance policies as retirement nears and the children go off on their own. But for late-age boomers with young children, eliminating life and disability coverage doesn't make sense. They may also need to plan on retiring later, perhaps not until age 70. That way, their savings will compound longer and they'll have some income to help out with college expenses.

It's not unusual today for an older husband to be thinking about retirement while his younger wife's career is going gangbusters. And an age difference can affect something as basic as deciding when a spouse should start taking Social Security payments. That was the case with David Perlmutter and his wife, Kathy. The 63-year-old Palo Alto (Calif.) entrepreneur sold his business, usedlaptops.com, in 2007 and decided to retire a year ago. His wife, 52, continues to work as a vice-president at the health-care information technology company Cerner. She contributes the maximum into her 401(k) plan to minimize current taxes. But David decided to start taking Social Security. His reasoning: They have two children under age 18. Since he is retired and claims the children as dependents on his taxes, each child gets $9,000 from Social Security. The total annual family benefit from Social Security is $36,000.

Perlmutter exemplifies another trend some might label unconventional but that's becoming more common—the stay-at-home dad. And, as women have long noted, remaining home with the kids can be a full-time job. "My wife works all the time," says Perlmutter. "It isn't really retirement, since I do all the cleaning, cooking, and taking care of the kids. It's funny how roles have reversed." |BW|

> **"Unless you have a very stable job, single moms need to focus on building up rainy day funds and paying down debt"**



Swardson-Wenham, with daughter, Vivien, lost her home to foreclosure

JONATHAN CHAPMAN

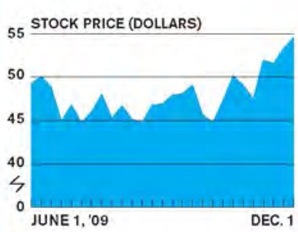
INSIDE WALL STREET | GENE MARCIAL



SYNGENTA'S GREEN SHOOTS

Huge worldwide demand for food and a robust new-product pipeline have sparked fresh growth at Syngenta (SYT), a global leader in crop protection and seed production. The Swiss company's stock hit a 52-week high of 54.86 (per American depositary receipt) on Dec. 1. With the strong moves in the grain markets, the price and volume outlook for next season is brighter, notes Andrew Stolt of Bank of America Merrill Lynch, who rates Syngenta a buy. He also sees margins on seeds rising as more products are launched. (Merrill did business with Syngenta).

INVIGORATED AT SYNGENTA



Data: Bloomberg

Syngenta's two new crop-protection products, Cruiser and Amistar, should boost yearly sales by $1 billion, according to CEO Michael Mack. Cruiser protects corn and soybean seeds from insects and also promotes healthier growth. Amistar is a fungicide widely used to derive higher yields, says Mack. The two are in such demand that Syngenta has tripled the output of Cruiser and doubled that of Amistar.

Brazil, the world's third-largest corn producer, recently approved use of a Syngenta feature to help stymie corn borers. Thomas Gilbert of UBS says the "high-margin vegetable seed business is growing fast, and Brazilian corn is emerging as a further strength." He sees profits of $3.19 per ADR in 2009, $3.65 in 2010, and $4.01 in 2011, vs. 2008's $3.20.

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WAFERGEN BIOSYSTEMS



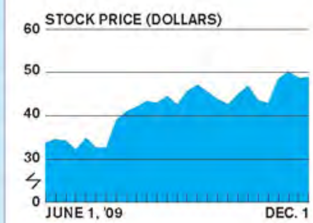
Data: Bloomberg

Probing Genes At Top Speed

A key part of drug discovery is studying so-called gene expression—or the way genes get switched on or off. WaferGen Biosystems (WGBS) believes it has an edge over rivals with its new system for predicting gene expression that can screen the genome at 10 to 60 times faster than competing systems, and for less money.

WaferGen's SmartChip Real-Time PCR System, to be launched in 2010's first quarter, should generate sales of $5 million to $8 million in 2010 and $15 million to $20 million in 2011, figures William Collins, CEO of hedge fund Brencourt Advisors, which owns shares. Drugmakers, medical labs, and university researchers are the main potential customers, he notes. And the market exceeds $3 billion. Elemer Piros of Rodman & Renshaw Capital Group rates WaferGen outperform, with a 12-month target of 7 for the stock, now at 1.65 a share.

CSX: FAST FREIGHT



Data: Bloomberg

The Momentum At CSX

Widespread signals that an economic recovery is in place, plus Warren Buffett's purchase of Burlington Northern Santa Fe on Nov. 3, have buoyed other rail stocks. Carl Birkelbach, president of Birkelbach Investment Securities, says CSX is the most attractive of the lot as it should gain immensely from the coming recovery. Its stock climbed to a 52-week high of 50.15 a share on Nov. 17, up from 20 on Mar. 9. With the stock now at 48.82, Birkelbach says there's at least a further 30% upside potential in the next 6 to 12 months.

George Pickral of investment firm Stephens rates the stock overweight, with a target of 59. "CSX can continue to grow earnings in any environment because of its pricing power and market-share gains," he says. Prices are still depressed at 50% below historical levels, Pickral says. He sees CSX earning $2.85 a share in 2009 and $3.20 in 2010.

BRAD TRENT; CHARTS BY DAVID FOSTER

Advertisement

Do you have constant RINGING in your ear?



Finally, new discovery for quiet relief!

A breakthrough by a rock drummer finds combination of scientifically advanced ingredients combined with homeopathy to silence the ringing, which could save thousands from risky and expensive treatments.

Every night for almost 18 years, if I couldn't find a fan, turn on a tv or find loud static from a vacant radio station, then sleeping was impossible. The high-pitched ringing, buzzing and humming kept me up at night. Sluggishness, tiredness and lost energy would be my nemesis the next day. Gathering the energy for my next gig was my goal everyday - a routine of coffee, then aspirin, which made it worse. I couldn't take it - it was a major problem. I couldn't sleep. I couldn't concentrate. I heard it constantly, I couldn't hide from it. Everywhere I went, it wouldn't go away…It drove me nuts! Headaches, depressive mood swings, testiness, constant state of anxiety. Due to the tenacity of Tinnitus (the ringing in the ears from exposure to loud noises, or in my case, pounding on drums and loud distorted guitar amps behind my head for years), I was determined to find real, pure, silent relief and I did with Quietus™…

Tinnitus - Who's at RISK?

- **Carpentry & Construction**
- **Residential Landscapers**
- **Mining, Drilling & Farming**
- **Airport Workers**
- **Firearms Enthusiasts**
- **Machine Operators**
- **Night Club Workers**
- **Night Club Partiers**
- **Musicians**
- **iPod Users**

Tinnitus Symptoms Worsen Into Your 40's.

The symptoms of Tinnitus are real. I had what 1 out of 6 Americans get: the symptoms associated with Tinnitus *(ti-nahy-tuh s)* from loud noises that worsen as you age, and in many cases lead to hearing loss.

Silence is now music to my ears.

I tried everything from hearing aid sound generators to ginkgo biloba, zinc and magnesium mineral doses to bio feedback. Some of these things helped reduce the ringing, but nothing worked short of expensive, risky surgery. Not until I discovered the active all-natural ingredients of my new product Quietus, the ringing in my ear for years was finally silenced.

"STOP the ringing, CALM the hissing. Let peace & mental clarity begin."

Just one small tab twice a day unleashes an exclusive proprietary blend of ingredients, including the same select herbs FDA compliant as Homeopathic Pharmacopoeia of the US. Quietus uses scientifically advanced technology that supports the body's own healing mechanism that cancels out symptoms such as roaring, buzzing & whizzing, and supports healthy functioning in the cochlea and auditory nerves...***safely & naturally***.

The Choice is Clear for Quiet Relief

	Quietus	Ginkgo Biloba	Minerals: Zinc/Mag.	Hearing Aids	Bio Feedback	TR Therapy	Surgery
Affordable	✓	✓					
Safe	✓	✓		✓	✓		
No Doctors	✓	✓					
Fast-Acting	✓		✓				✓
Effective	✓					✓	✓
Convenient	✓						
Money-Back Guarantee	✓						

No other treatment that I know of matches the relief that Quietus provides with effectiveness, speed and convenience. With Quietus, the ringing stops and the comfortable silence will peacefully lull you to sleep at bedtime. When the ringing stops, remembering people's names becomes easier. Mental clarity becomes your calling card. Intense focus becomes your edge…

BERNARD - CREATOR, DRUMMER.

Special limited promotion

Quietus is not available in stores. Quietus is for personal use only. To protect it's proprietary formula, as well as your risk free trial, Quietus is by special request directly from our lab. I am so confident in the advanced technology of Quietus and I want you to experience the same life- altering relief I did when first taking Quietus that you receive a special **30-day RISK-FREE trial*** by calling us direct! Ask how to receive a **FREE Supply** with your order.

RISK-FREE TRIAL 30 DAY

1-800-640-4302

*Shipping and handling non-refundable. www.QuietRelief.com

078 Readers duke it out over bank practices
080 Tech & You: Virtues of the Intel Reader

BOOKS | BY HARDY GREEN

Of Meltdowns, Moguls, and Mad Ave.

The year's best books take on the Great Recession, the reasons we work, and more



ZOHAR LAZAR

So you think TV and magazines practice herd journalism? Take a look at book publishing's copycat ways. For every *The Lost Symbol* and *Freakonomics*, there are scores of wannabe volumes conjuring up mysterious conspiracies and demystifying economic phenomena. The number of Malcolm Gladwell doppelgängers seems to grow yearly.

It's hardly a wonder, then, that the financial meltdown prompted a dozen or more titles, recapitulating developments in a variety of ways. Among the best is **House of Cards: A Tale of Hubris and Wretched Excess on Wall Street** (Doubleday) by financial writer William D. Cohan. The page-turner documents how Bear Stearns, once the Street's preeminent bond shop, flamed out and had to sell itself to JPMorgan Chase for a pittance. The firm had ridden the housing boom with arcane mortgage-backed securities, but its C-suite had shockingly little idea of its exposure to the toxic stuff, says Cohan. In the end, Bear earned billions setting the stage for the world to lose trillions.

You say you've had enough of Wall Street's trauma ward? Well, I'm just getting started, but there are plenty of other topics in *BusinessWeek*'s annual list of the year's top business books.

Perhaps the most comprehensive of the meltdown books is *New York Times* columnist Andrew Ross Sorkin's **Too Big to Fail: The Inside Story of How Wall Street and Washington Fought**

076 BOOKS



to Save the Financial System—and Themselves (Viking). The account begins days after the Bear Stearns purchase and ends shortly after the government decided to inject tens of billions into the big banks in order to save the system. This volume will appeal to a broad audience owing to its quirky details and little-known stories.

The New Yorker writer John Cassidy says his **How Markets Fail: The Logic of Economic Calamities** (Farrar, Straus & Giroux) examines the rise and fall of free-market ideology. In contrast to "utopians" who he says advocate "a rigid and unquestioning devotion" to self-interest and competition, Cassidy favors what he calls "reality-based economics"—including the work of John Maynard Keynes. Said reviewer Christopher Farrell: The "ambitious" volume "brings ideas alive."

Another book that emphasizes the role of human actions, and human frailty, is **False Economy: A Surprising Economic History of the World** (Riverhead) by *Financial Times* world trade editor Alan Beattie. Roaming freely through the corridors of history, Beattie spots economic distortions caused by misguided trade pacts and greedy interest groups. He also discovers economic triumphs despite such presumed barriers as corruption or religious tradition. *False Economy* is filled with insights, said reviewer Jack Ewing.

A more ground-level view of human enterprise can be found in **The Pleasures and Sorrows of Work** (Pantheon) by Alain De Botton, a writer of wide-ranging interests. In a photo-loaded work, De Botton surveys a variety of jobs—career counseling, tuna fishing, even rocket science—and offers various musings. "When does a job feel meaningful?" he asks. "Whenever it allows us to generate delight or reduce suffering in others." The author finds both humor and grief in our labors.

One book defines work as meaningful "whenever it allows us to generate delight or reduce suffering in others"

ADS, OIL, AND VODKA

It was a good year for biography and business history. **The King of Madison Avenue: David Ogilvy and the Making of Modern Advertising** (Palgrave Macmillan), by former ad man Kenneth Roman, is an entertaining portrait of the legendary figure behind Ogilvy & Mather. Ogilvy drew many key life lessons from the odd jobs (sous-chef, door-to-door salesman) he performed in his twenties. These contrasted sharply with his late-life baronial lifestyle. Ogilvy is best remembered for his ad coups, including the eyepatch-wearing Hathaway shirt man.

The Big Rich: The Rise and Fall of the Greatest Texas Oil Fortunes (Penguin Press) elegantly interweaves the stories of four petroleum barons of the Lone Star State: Roy Cullen, Clint Murchison, Sid Richardson, and H.L. Hunt. Author Bryan Burrough offers particularly compelling accounts of Cullen, the fifth-grade dropout who became the richest man in the U.S., and Hunt, the onetime professional poker player who gained fame bankrolling right-wing political causes. All benefited from what the author calls "among the greatest periods of wealth creation in American history."

Another tale of fierce determination and entrepreneurial drive is former *BusinessWeek* staffer Linda Himelstein's **The King of Vodka: The Story of Pyotr Smirnov and the Upheaval of an Empire** (Harper). Smirnov, who began his enterprise in 1864, not only invented his own recipes but also proved a skilled marketer. By 1886 he had become the official vodka purveyor to the Tsar. After the Bolsheviks nationalized the outfit, the brand was reborn in 1920s Europe and later in the U.S., thanks to émigré Smirnovs who inherited the family's go-getter genes.

Robert Skidelsky's **Keynes: The Return of the Master** (PublicAffairs) makes a strong case for rereading one of the seminal figures of modern macroeconomics. A key Keynesian concept is that the future is unpredictable, but there will certainly be economic shocks, Keynes felt, and the system must include mechanisms that can respond. Keynes also emphasized the connection between economics and an ethical life.

Finally, veteran *New Yorker* writer Ken Auletta's **Googled: The End of the World As We Know It** (Penguin Press) is a deeply reported profile of the search powerhouse. Google's engineering-focused culture, says the author, is both its greatest strength and its Achilles' heel: Having the best search technology has let Google dominate the search-ad market, but it may have made it insensitive to criticism. Auletta concludes: "If Google maintains its deposit of public trust ... and if it stays humble and moves with the swiftness of a fox, it will be difficult to catch." |BW|

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How to reach *BusinessWeek*

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WALL STREET
BULLDOZING CITY BUDGETS?

When a transaction with Wall Street blows up at great cost to public entities, who's to blame? The answer depends on whether you see municipalities and nonprofits as less sophisticated than the big banks. Readers of "Wall Street vs. America" (In Depth, Nov. 30) duked it out online and e-mailed. Some said local officials were the dupes of conniving bankers. Many others argued that public officials should have been aware of the risks. –*Theo Francis*

Atrocious behavior by those who already made fortunes selling bad mortgage-backed securities.... Now they raise credit-card rates on even those with great credit and stick it to cities like Detroit when they are down.

Screen name: Robert Squires



One more example of how the same people who torpedoed the economy in the first place are now plundering bankrupt cities, forcing draconian cuts in human services in order to rake in their obscene profits.

Screen name: Winston Rockwell

No one has been suckered by Wall Street.... City officials weren't pulled into a back room and forced to sign something without reading it. People forget how much due diligence it takes to hammer out these deals. The city had lawyers and finance people advising them. The bet went out of their favor, that's all.

Screen name: Mark-Anthony

This is outrageous, but it's not all on Wall Street. Who were the boards, executive directors, and CFOs buying these "investments"? One of the basic tenets of investing is to buy what you understand. What induced these people to buy except laziness and greed? The taxpayers need to wrestle Wall Street legally on these matters.

John Bacon Jr.
ST. CHARLES, ILL.

Wall Street isn't innocent here. But our pension, utility, transit, and governmental players are as culpable, if not more. Having gambled away the house, they now want us to believe they were the victims of some fraud.

Screen name: Jack Heismann

CAP AND TRADE
HOW CARBON OFFSETS WORK IN CALIFORNIA

"A Big Loophole in Cap and Trade" (What's Next, Nov. 30) reported that the sale of carbon offsets from the Conservation Fund's California forest lands represents duplicate payment for previous commitments to preserve trees. In fact, the loans associated with the purchase of these properties expressly allow the fund to harvest timber to help cover debt service and operating expenses.

The fund has harvested about 47% less than the total allowable amount, even as timber prices have fallen—a reduction that's possible only because of the carbon offset revenues.

Chris Kelly
California Program Director
The Conservation Fund
LARKSPUR, CALIF.

The story failed to note that California's carbon offset protocol is tougher than the state's stringent state forestry regulations. We at Sierra Pacific must submit a binding 100-year commitment to carbon offset projects—with deed restrictions to protect the forests—and invest millions to assure we are meeting or exceeding our carbon commitment. All this must be independently verified. Only then can an offset sale be made.

Mark Pawlicki
Director of Government Affairs
Sierra Pacific Industries
REDDING, CALIF.

FINANCIAL REGULATION
SARBANES-OXLEY: COSTLY AND INEFFECTIVE

Regarding "These Men Could Kill SarbOx" (In Depth, Nov. 30): I hope SarbOx is eliminated. It certainly didn't help control Bear Stearns, Lehman, and numerous failed banks. If the Public Company Accounting Oversight Board cannot prevent financial collapses of that magnitude, why should public corporations have to spend millions of dollars to adhere to useless "control" mechanisms?

Joseph D'Agostin
NORWALK, CONN.

CORRECTIONS & CLARIFICATIONS
"Can Roche Leave Genentech Alone?" (What's Next, Dec. 7) misspelled the name of a Roche senior executive who was key to the integration of the two companies. He is Pascal Soriot.

TOMER HANUKA

COMPANY INDEX

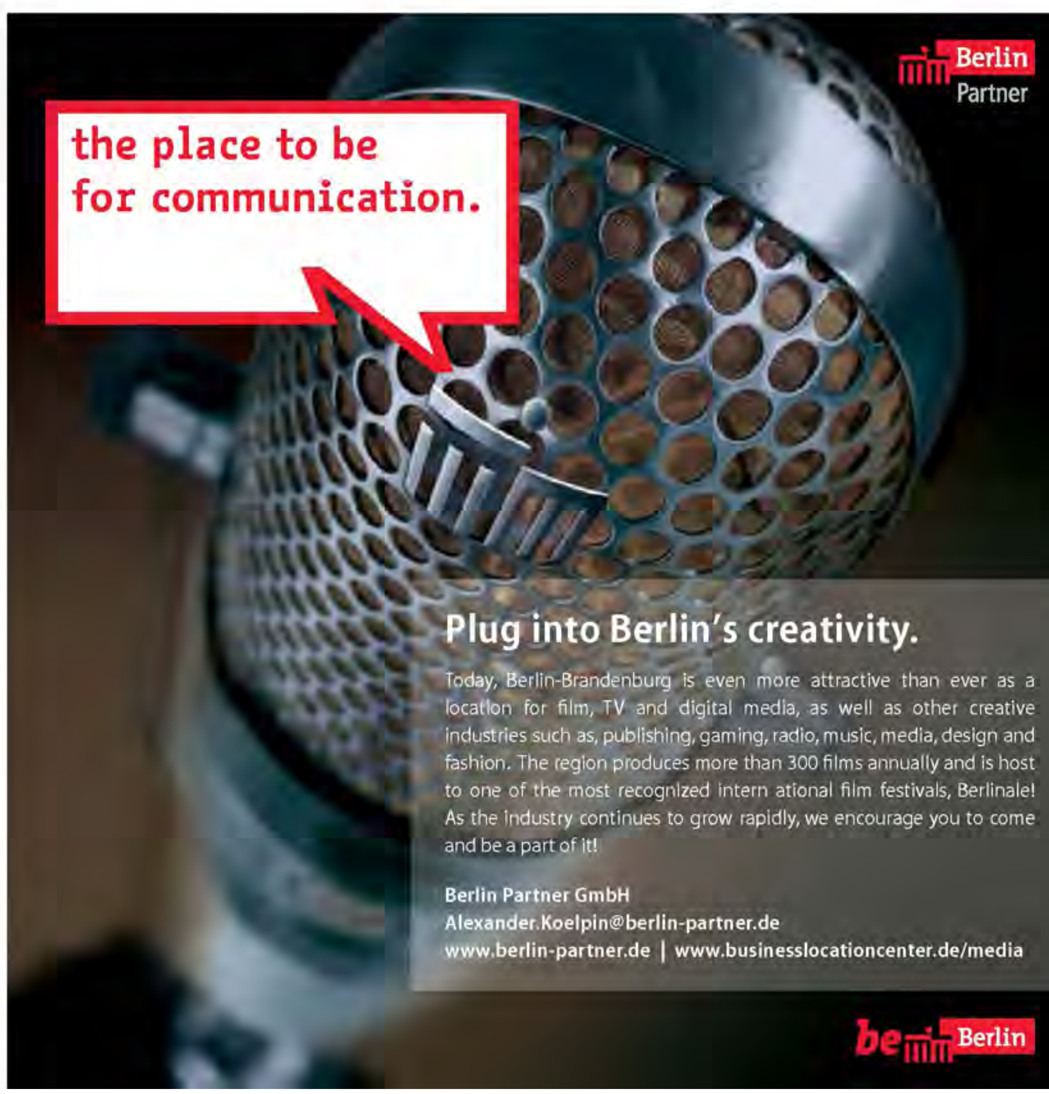
This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names.
Companies listed only in tables are not included.

A ABC (DIS) 17
Abraaj Capital 34
Aeropostale (ARO) 61
Airbus 34
AlixPartners 38
Alstom 65
Amazon.com (AMZN) 4
AIG 4
AOL (TWX) 42
Apple (AAPL) 4, 42, 54, 57, 64
Artemis Wealth Advisors 28
AT&T (T) 4
Auto Trends 20
B Balani Custom Clothes 9
Banco de México 26
Bank of America (BAC) 22, 28, 30
Bank of England 22
Barclays (BCS) 28, 34, 67
Barneys New York 38
Bath & Body Works 61
Bear Stearns 28
Best Buy (BBY) 57, 64
Birkelbach Investment 73
Blankinship & Foster 70
Bloomberg 22, 67, 80
Boeing (BA) 20, 34
Brencourt Advisors 73
Burlington Northern (BNI) 73
BuyWithMe 9
C Cadbury (CBY) 28
Capital Alpha Partners 22
Carlton 9
Carlyle Group 34
Cerner (CERN) 70
Cisco (CSCO) 34, 57, 65
Citigroup (C) 22, 28, 32, 58
Clayton Holdings 30
CLSA 32
Colony Capital 38
Comcast (CMCSA) 4
CompuServe 42
comScore (SCOR) 4, 9
Coremetrics 4
Credit Suisse (CS) 64
Cross River 62
CSA 9
CSX (CSX) 73
CWCapital 30
D Detour Gold 28
Deutsche Bank (DB) 34
Dick's Sporting Goods (DKS) 61
Doosan 58
DP World 38
Dubai World 34, 38
E eBest 58
Edmunds.com 20
EFG-Hermes 34
Eurasia Group 34
F Facebook 42
FBR Capital (FBCM) 30
First American CoreLogic 30
Fitch Ratings 26
Ford (F) 20
Forrester Research (FORR) 9
G Gannett (GCI) 42
Gartner (IT) 57
General Electric (GE) 4, 34
General Motors 4, 20
Gilt Groupe 17
Global X 67
Go Home Gorgeous 70
Goldman Sachs (GS) 28, 57, 67
Good Energies 65
Google (GOOG) 42, 75
Graceful Concepts & Images 62
Gradient Analytics 30
Groupon 9
H Holt Renfrew 38
HSBC (HBC) 26, 34, 38
Hyundai 58
I IAC (IACI) 42
IBM (IBM) 65
Idearc 28
Iluka Consulting 28
Infinity World Holding 38
Intel (INTC) 80
International Strategy & Investment Group 22
Interpublic Mediabrands (IPG) 42
Investment Company Institute 67
Istithmar World 38
J J.Crew (JCG) 42
JPMorgan Chase (JPM) 12, 28, 75
K Korea Electric 58
Korea Investment & Securities 58
Kraft Foods (KFT) 28
L Las Vegas Sands (LVS) 32
Leo Burnett 42
LG 58
LivingSocial 9
Lloyds Banking (LYG) 28
M Marina Bay Sands 32
Martha Stewart (MSO) 17
Matthews Korea Fund 68
McClatchy (MNI) 42
McKinsey 57
Merrill Lynch (BAC) 73
MGM Mirage (MGM) 30
Microsoft (MSFT) 34, 42, 54
Midway Capital 30
Monitor Group 58
Moody's Investors Service (MCO) 38
Morgan Stanley (MS) 34
Morningstar (MORN) 67
Mövenpick 9
MSCI 68
MySpace (NWS) 42
N Nakheel 34, 38
NBC Universal 4
Nike (NKE) 61
Nokia (NOK) 4
O Ogilvy & Mather 75
Openbase 58
Oracle (ORCL) 57
P Paulson & Co. 28
Perry Capital 38
Port & Free Zone World 38
R Radio Shack (RSH) 64
Ralph Lauren (RL) 61
Reebok International 61
Rodman & Renshaw (RODM) 73
Rothschild 57
Roubini Global Economics 38
Royal Bank of Scotland (RBS) 28, 38
S Samsung 58, 68
Sanford C. Bernstein 4, 42
Sierra Pacific Industries 78
SJM Holdings 32
SK Telecom 68
S&P (MHP) 34, 67
Sprint (S) 64
Staples (SPLS) 61
Starwood Capital 38
Stephens 73
Suntech Power Holdings (STP) 65
SunTrust (STI) 30
Syngenta (SYT) 73
T Tata Group 57
Time Warner (TWX) 42
Topix 42
Toys "R" Us 61
Tribune 42
Twitter 9, 80
U UBS (UBS) 34, 73
V Vivendi 4
W Wachovia (WFC) 30
WaferGen Biosystems (WGBS) 73
Wal-Mart Stores (WMT) 4, 64
Wells Fargo (WFC) 30
Y Yahoo! (YHOO) 42

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Tell Me a Story, Intel

For the blind or visually impaired, its Reader could be as big a boon as braille

Great advances in digital technology shower all kinds of benefits on society—among them, life-altering opportunities for people with disabilities. Innovations of this order range from digital hearing aids and cochlear implants to computerized prosthetic limbs. Unfortunately, such products are often relegated to a ghetto known as "assistive technology," where high prices and limited distribution place them beyond the reach of many people who might benefit.

Intel is trying to change that as part of a major corporate push into health care. Its new Digital Health Group has just come out with a remarkable product, the Intel Reader, designed to make printed matter accessible to millions of people who find reading difficult or impossible, either because of vision problems or learning disabilities such as dyslexia.

The Intel Reader succeeds because it does such a good job of integrating three well-established technologies. It uses a digital camera to capture printed material, optical character recognition to convert print to computer-readable text, and speech synthesis to turn the text into comprehensible spoken language.

The Reader is a 1.4-pound unit about the size and shape of a paperback. It is designed from the ground up for use by the visually impaired. All menus are presented in both spoken and visual form—displayed on a 4.3-inch black-and-white screen that can magnify type up to about an inch tall. The buttons that control functions are large and easily distinguished by their shape and placement. At $1,500, the Reader is expensive by consumer-electronics standards, but relatively cheap for the assistive technology market, where low volumes keep prices high.



The Intel Reader combines a digital camera, OCR, and speech synthesis

The primary way to get content into the Reader is by photographing pages using the built-in 5-megapixel camera and flash. A copy stand called the Portable Capture Station ($400) makes it relatively fast and easy to scan large volumes of text, especially from books. As soon as the words are captured, the Reader begins the text conversion, and you can have it start reading aloud while the conversion is still in progress. A USB port lets you import any text file—for example, books from Project Gutenberg, a community-based project that makes texts in the public domain available for free download.

The speech is surprisingly good. The voice is robotic, but with generally correct pronunciation and good inflection

The text-to-speech synthesis is surprisingly good. The voice is robotic, but with generally correct pronunciation and good inflection. You can set the reading speed as high as 500 words per minute. I found anything faster than 250 incomprehensible, but a listener's ability to understand very rapid speech improves with experience.

Scanning in printed material also requires some practice. Although the software is supposed to compensate for the curve of pages at the binding, you must learn how to position the camera properly, even if you are using the copy stand. The simpler the book's formatting, the more likely the process is to succeed. Footnotes, for example, can confuse the Reader, and technical material, such as mathematics notation, tends to produce garble rather than formulas. (Intel says this is a failing of the OCR software.)

Despite the limitations and its steep price, the Reader is an important step toward making adaptive technology more accessible. Let's hope it is the first of many. |BW|

This column marks my farewell to Tech & You after 15 years. I left BusinessWeek *on Dec. 1 upon the magazine's acquisition by Bloomberg. It has been a wonderful ride, but it is time for me to move on. I will especially miss the many contacts I have had with readers over the years, and I would love to hear from any of you at steve@wildstrom.com. For news of my next move, please follow swildstrom at Twitter.*

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